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TRANSCRIPT OF RECORD

Supreme Court of the United States

OCTOBER TERM, 1929

No. 226

THOMAS A. EARLY, RECEIVER OF THE FARMERS & MERCHANTS NATIONAL BANK OF LAKE CITY, PETITIONER,

vs.

FEDERAL RESERVE BANK OF RICHMOND

ON WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE FOURTH CIRCUIT

PETITION FOR CERTIORARI FILED JULY 8, 1929

CERTIORARI GRANTED OCTOBER 21, 1929

(34,357)

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TRANSCRIPT OF RECORD

CAPTION

IN THE DISTRICT COURT OF THE UNITED STATES FOR THE EASTERN DISTRICT OF SOUTH CAROLINA.
AT LAW.

At a District Court of the United States for the Eastern District of South Carolina, begun and held at the Court House in the City of Florence, S. C., on the fourth Monday of April, being the twenty-third day of the same month, in the year of our Lord one thousand nine hundred and twenty-eight, and on May 1st, 1928, adjourned to Charleston, S. C.

Present: The Honorable Ernest F. Cochran, United States District Judge for the Eastern District of South Carolina.

Among other were the following proceedings:

COMPLAINT

(2) Filed November 9, 1927.

IN THE DISTRICT COURT OF THE UNITED STATES FOR THE EASTERN DISTRICT OF SOUTH CAROLINA.
AT LAW.

Thos. A. Early, as Receiver of The Farmers and Merchants National Bank of Lake City, S. C., a national banking association, Plaintiff,

vs.

The Federal Reserve Bank of Richmond, a banking corporation duly organized under the Federal Reserve Act, Defendant.

The plaintiff above named, complaining of the defendant herein, alleges:

1. That the plaintiff, Thos. A. Early, was on October 18, 1926, duly appointed Receiver of the Farmers and Merchants National Bank of Lake City, South Carolina, by the Comptroller of the Currency; that he qualified as Receiver and has ever since been and now is serving and acting as such Receiver. That said Farmers and Merchants National Bank of Lake City, South Carolina, is a national banking association and, prior to its closing and suspension as hereinafter set forth, was a member of the Federal Reserve System of banking provided for by the Act of Congress of December 23, 1913, and acts amendatory thereof, and as such member owned 78 shares of stock in the Federal Reserve Bank of Richmond, and was engaged in business and had its office at Lake City, South Carolina, in the Eastern District of South Carolina.

2. That the defendant, the Federal Reserve Bank of Richmond, is a banking corporation, duly organized under said Federal Reserve System, with a district or territory assigned to it which includes the State of South Carolina.

(3) FIRST CAUSE OF ACTION

For the first cause of action against defendant, plaintiff alleges:

1. That, following the close of business on Saturday, October 9, 1926, the said Farmers and Merchants National Bank of Lake City, South Carolina, was, on the evening of said day, closed on account of insolvency by resolution of its Board of Directors. That said insolvent bank, at the time of said suspension and closing, had on deposit with the defendant, the Federal Reserve Bank of Richmond, in its reserve account, subject to check, the sum of Twenty two Thousand Eighty-eight Dollars and Forty-eight cents ($22,088.48). That notice of said suspension and closing was duly sent to and received by said defendant.

2. That plaintiff, as Receiver of said insolvent bank, on, to wit, the 19th day of February, 1927 made demand upon defendant the Federal Reserve Bank of Richmond,

for the sum of $7,187.86, constituting part of said reserve deposit balance of Twenty Two Thousand Eighty-eight Dollars and Forty-eight cents ($22,088.48), and on 11th day of May, 1927, demanded payment of the sum of $14,900 62 constituting the residue of said reserve deposit balance, but defendant has failed and refused to pay the plaintiff said sums or any part thereof, and there is now due and owing by the defendant to the plaintiff the sum of Twenty Two Thousand Eighty-eight Dollars and Forty-eight cents ($22,088.48), together with interest upon the sum of $7,187.86 at the rate of six per cent per annum from the 19th day of February, 1927, and interest upon the sum of $14,900.62 from the 11th day of May, 1927, at the rate of six per cent per annum, exclusive of all set offs and just grounds of defense.

SECOND CAUSE OF ACTION

For the second cause of action against the defendant, the plaintiff alleges:

1. That prior to the said closing and suspension of said Farmers and Merchants National Bank of Lake City, South Carolina, set forth in the aforesaid first cause of action, said Farmers and Merchants National Bank of Lake City, South Carolina, had duly subscribed for and (4) had been allotted 78 shares of the stock of the said Federal Reserve Bank of Richmond, and had paid on said subscription the sum of Thirty Nine Hundred Dollars ($3900). That after said closing and suspension of said Farmers and Merchants National Bank of Lake City, South Carolina, plaintiff, as Receiver of said Farmers and Merchants National Bank, surrendered said 78 shares of stock to the defendant, the Federal Reserve Bank of Richmond, in accordance with the provisions of the aforesaid Act of Congress of December 23, 1913, and acts amendatory thereof, and on, to wit, the 20th day of May, 1927, demanded of said defendant the sum of Thirty Nine Hundred Dollars ($3900), constituting the surrender value of said stock, and also demanded the sum of $215 15/100 representing accrued dividends upon said surrendered stock, but defendant has failed and refused to pay the same to the plaintiff or any part thereof, and there is now due and owing by the defendant to the plain-

tiff the said sum of Thirty Nine Hundred Dollars ($3900), and said sum of $215 15/100, representing accrued dividends, with interest upon the aggregate amount thereof at the rate of six per cent per annum from the 20th day of May, 1927, exclusive of all set offs and just grounds of defense.

Wherefore, plaintiff prays judgment against the defendant, the Federal Reserve Bank of Richmond:

1. ON THE FIRST CAUSE OF ACTION:

For the sum of Twenty Two Thousand Eighty-eight Dollars and Forty-eight cents ($22,088.48), together with interest upon the sum of $7,187.86, at the rate of six per cent per annum from the 19th day of February, 1927, and interest upon the sum of $14,900.62, at the rate of six per cent per annum from the 11th day of May, 1927.

2. ON THE SECOND CAUSE OF ACTION:

For $4115 15/100, together with interest thereon at the rate of six per cent per annum from the 20th day of May, 1927.

R. E. WHITING,

_____,

Attorneys for Plaintiff.

ANSWER AND COUNTERCLAIM

(5) Filed Feby. 15, 1928.

The defendant, Federal Reserve Bank of Richmond, answering the complaint of the plaintiff, herein says:

1. Defendant, Federal Reserve Bank of Richmond, admits the allegations of the first paragraph of the complaint.

2. Defendant, Federal Reserve Bank of Richmond, admits the allegations of the second paragraph of the complaint.

ANSWER TO FIRST CAUSE OF ACTION

Defendant, Federal Reserve Bank of Richmond, answering the allegations set out as the plaintiff's first cause of action says:

Defendant, Federal Reserve Bank of Richmond, admits all matters and things alleged as the first cause of action except that the Federal Reserve Bank of Richmond denies that the Farmers and Merchants National Bank of Lake City, S. C., had on deposit with the Federal Reserve Bank of Richmond at the time of the closing of the Farmers and Merchants National Bank of Lake City, S. C., the sum of twenty-two thousand eighty-eight dollars and forty-eight cents ($22,088.48), and says that the said balance was subject to certain counter claims and demands of the Federal Reserve Bank of Richmond, which are more fully described in the affirmative defense and counter claim which is hereafter set forth, and the Federal Reserve Bank of Richmond denies that it is indebted to the plaintiff in any sum whatsoever.

ANSWER TO SECOND CAUSE OF ACTION

Defendant, Federal Reserve Bank of Richmond, (6) answering the allegations set forth in the plaintiff's second cause of action, says:

Defendant, Federal Reserve Bank of Richmond, admits all matters and things alleged as the second cause of action, except that the Federal Reserve Bank of Richmond denies that it is indebted to the plaintiff in the sum of thirty-nine hundred dollars ($3,900.00) and two hundred fifteen dollars and fifteen cents ($215.15), as in the complaint alleged, or in any other sum whatsoever; and the Federal Reserve Bank of Richmond says that the surrender value of the stock described in the complaint and the dividends thereon are under the terms of the Federal Reserve Act and other acts of Congress amendatory thereof properly applicable to the counter claims and demands set forth in the affirmative defense and counter claim hereafter:

AFFIRMATIVE DEFENSE AND COUNTER CLAIM

Further answering the complaint of the plaintiff and by way of affirmative defense and statement of counter claim, the defendant, Federal Reserve Bank of Richmond, says:

1. On October 7, 1926, the Federal Reserve Bank of Richmond sent to the Farmers and Merchants National Bank of Lake City, S. C., for collection and payment checks drawn upon that bank by depositors thereof amounting to fourteen thousand nine hundred thirty-four dollars and twelve cents ($14,934.12), which checks had been received by the Federal Reserve Bank of Richmond on deposit or for collection from member banks, as provided in the Federal Reserve Act.

2. On October 8, 1926, the Farmers and Merchants National Bank of Lake City, S. C., acknowledged receipt of said checks, and accepted, cancelled, and charged to the account of the drawers thereof certain of said checks amounting to fourteen thousand nine hundred dollars and sixty-two cents ($14,900.62), and refused to pay and returned to the Federal Reserve Bank of Richmond certain of said checks amounting to thirty-three dollars and fifty cents ($33.50).

3. On October 8, 1926, the Federal Reserve Bank of
(7) Richmond sent to the Farmers and Merchants National Bank of Lake City, S. C., for collection and payment checks drawn upon that bank by depositors thereof amounting to twenty-one thousand forty-one dollars and two cents ($21,041.02), which checks the Federal Reserve Bank of Richmond had received on deposit or for collection, as provided in the Federal Reserve Act.

4. On October 9, 1926, the Farmers and Merchants National Bank of Lake City, S. C., acknowledged receipt of said checks and accepted, cancelled, and charged to the account of the drawers thereof certain of said checks amounting to twenty thousand one hundred seventy dollars and seventy-one cents ($20,170.71), and refused to pay and returned unpaid certain of said checks amount-

ing to eight hundred seventy dollars and thirty-one cents ($870.31).

5. The Federal Reserve Bank of Richmond and the Farmers and Merchants National Bank of Lake City, S. C., had agreed prior to the time above mentioned that the amount of checks thus sent to the Farmers and Merchants National Bank of Lake City, S. C., might be charged against the reserve account kept by the Farmers and Merchants National Bank of Lake City, S. C. with the Federal Reserve Bank of Richmond, at any time, and that such checks as were refused payment and returned unpaid should be credited to the Farmers and Merchants National Bank of Lake City, S. C., when duly returned.

6. For sometime prior to the dates above mentioned it had been the practice of the Federal Reserve Bank of Richmond to allow a period of three business days to elapse before charging to the account of the Farmers and Merchants National Bank of Lake City, S. C., the amount of the checks sent to it for collection and payment, as above mentioned, in order to allow the Farmers and Merchants National Bank of Lake City, S. C., an opportunity to examine such checks and to determine whether or not it would accept and pay the same or would return them as unpaid.

7. On October 11, 1926, the Federal Reserve Bank of Richmond charged to the account of the Farmers and Merchants National Bank of Lake City, S. C., the amount (8) of all checks sent to it on October 7th and thereafter credited the Farmers and Merchants National Bank of Lake City, S. C., with the amount of checks returned unpaid.

8. On October 11, 1926, the Farmers and Merchants National Bank of Lake City, S. C., had to its credit in its reserve account with the Federal Reserve Bank of Richmond the sum of twenty-two thousand eighty-eight dollars and forty-eight cents ($22,088.48), against which was chargeable, as above set out, the amount of all checks sent to the Farmers and Merchants National Bank of Lake City, S. C., upon October 7, 1926, and October 8, 1926.

9. On October 11, 1926, the Federal Reserve Bank of Richmond charged to such reserve account of the Farmers and Merchants National Bank of Lake City, S. C., the amount of checks sent to the Farmers and Merchants National Bank of Lake City, S. C., on October 7th, and credited to such account the amount of the checks sent upon that day and returned unpaid. The balance of said reserve account remaining after the charges and credits above mentioned was seven thousand one hundred eighty-seven dollars and eighty six cents ($7,187.86).

10. This balance the Federal Reserve Bank of Richmond retained and is now retaining as a credit and a part payment upon the amount due by the Farmers and Merchants National Bank of Lake City, S. C., in payment for checks sent to it by the Federal Reserve Bank of Richmond on October 8, 1926, and accepted and cancelled by the Farmers and Merchants National Bank of Lake City, S. C., on October 9, 1926.

11. After allowing a credit to the Farmers and Merchants National Bank of Lake City, S. C., for the sum of seven thousand one hundred eighty-seven dollars and eighty-six cents ($7,187.86), there remained due on account of checks sent to the Farmers and Merchants National Bank of Lake City, S. C., on October 8th the sum of twelve thousand nine hundred eighty-two dollars and eighty-five cents ($12,982.85), which said sum was never paid by the Farmers and Merchants National Bank of Lake City, S. C., to the Federal Reserve Bank of Richmond.

12. The Federal Reserve Bank of Richmond filed with Thos. A. Early, Receiver of the Farmers and Merchants
(9) National Bank of Lake City, S. C., a claim for the above mentioned sum of twelve thousand nine hundred eighty-two dollars and eighty-five cents ($12,982.85), which claim the said Thos. A. Early, Receiver of the Farmers and Merchants National Bank of Lake City, S. C., refused to pay.

Wherefore, the Federal Reserve Bank of Richmond prays that its claim for twelve thousand nine hundred eighty-two dollars and eighty-five cents ($12,982.85) with

interest from October 12, 1926, subject to a credit of four thousand one hundred fifteen dollars and fifteen cents ($4,115.15), as of May 20, 1927, on account of the stock and accrued dividends thereon mentioned in the plaintiff's second cause of action may be established against Thos. A. Early, Receiver of the Farmers and Merchants National Bank of Lake City, S. C., plaintiff herein, and that the defendant Federal Reserve Bank of Richmond, may have judgment against the said Thos. A. Early, Receiver of the Farmers and Merchants National Bank of Lake City, S. C., payable out of the assets of the Farmers and Merchants National Bank of Lake City, S. C., in his hands as Receiver.

M. G. WALLACE,
Attorney for Federal Reserve
Bank of Richmond.

State of Virginia,
City of Richmond, to-wit:

George J. Seay, being duly sworn, deposes and says that the matters and things alleged in the above answer are of his own knowledge true, and that he makes this verification because the defendant, Federal Reserve Bank of Richmond, is a corporation, and he is an officer thereof, to-wit: its Governor.

GEORGE J. SEAY.

Subscribed and sworn to before me this 23rd day of November, 1927.

M. G. CRAWFORD,
(Seal) Notary Public.

My Commission expires June 5th, 1929.

REPLY

(10) Filed March 14, 1928.

The Plaintiff, replying to the affirmative defense and counter claim set up in defendant's answer, alleges:

1. The items mentioned in paragraphs number 1 and number 3 of the affirmative defense and counter claim were received by the Federal Reserve Bank of Richmond for deferred credit, and had not become available for withdrawal or other use by the sending banks at the time of the suspension and closing of the Farmers and Merchants National Bank, Lake City, S. C.

2. In receiving and handling such checks for collection, the Federal Reserve Bank of Richmond did not become the owner of the paper, but acted only as agent of the banks from which it received the checks.

3. The Federal Reserve Bank of Richmond was notified of the suspension and closing of the Farmers and Merchants National Bank of Lake City, S. C., before the charge was made on October 11th, 1926 against the reserve account of such insolvent bank.

4. Upon notice of the suspension and closing of the Farmers & Merchants National Bank of Lake City, S. C., the authority of the Federal Reserve Bank under the agreement set out in paragraph number 5 was revoked; and thereafter no right existed on the part of the Federal Reserve Bank of Richmond to charge the reserve account of the Farmers and Merchants National Bank with any outstanding collection items.

5. The claim of the Federal Reserve Bank of Rich-
(11) mond in respect to such outstanding collection items does not exist in its own right, but only as trustee for various of its depositors; and such claim is not a proper subject of counter claim to the action brought by plaintiff.

R. E. WHITING,
Attorney for Plaintiff.

STIPULATION WAIVING A TRIAL BY JURY

(12) Filed March 14, 1928.

It is hereby agreed that a jury shall be waived; and that all issues in the above entitled cause shall be sub-

mitted to the Court for trial and determination; this submission to be made upon the stipulation and agreed statement of facts which shall be attached hereto.

R. E. WHITING,
Attorney for Plaintiff.

M. G. WALLACE,
Attorney for Defendant.

November 23rd, 1927.

ORDER OF JUDGMENT

(13) Filed May 9, 1928.

IN THE DISTRICT COURT OF THE UNITED STATES FOR THE EASTERN DISTRICT OF SOUTH CAROLINA.
AT LAW.

Thos. A. Early, as Receiver of the Farmers and Merchants National Bank of Lake City, S. C., a national banking association, Plaintiff,

vs.

Order of Judgment

The Federal Reserve Bank of Richmond, a banking corporation duly organized under the Federal Reserve Act, Defendant.

This action was tried under an agreement waiving jury, upon a stipulation of facts. Certain exhibits are attached to, or referred to, in the stipulation. The matters set forth in paragraphs one to sixteen in the stipulation and agreed statement of facts are found to be true and are hereby adopted as the special findings of the court and made a part of this judgment.

Two causes of action are set out in the complaint:

(1) For the recovery of the deposit account of $22,088.48 standing on the books of the Federal Reserve Bank of Richmond when the Farmers and Merchants National Bank of Lake City closed its doors;

(2) For the surrender value of 78 shares of stock in the Reserve Bank, amounting, on May 20, 1927, to $4115.15.

The Reserve Bank, "as trustee for various of its depositors", has filed a claim against the insolvent bank for $12,982.85. The amount of this claim is made a counter-claim in the answer of defendant.

From the examination of pertinent authorities submitted to me, and considering the facts and circumstances appearing in the stipulation of facts, together with the statutes, regulations and circulars governing the banking and clearing house operations of the Reserve Bank, I find that when the Farmers and Merchants National Bank of Lake City closed its doors on October 9th, 1926, the said bank then had a credit on the books of the Reserve Bank, after making all proper allowances and de-
(14) ductions, in the amount of $22,088.48. The charges made on account of the outstanding cash letters against the insolvent bank, I do not regard as proper allowances or deductions. The right of the Reserve Bank to make the charges terminated with the insolvency of the member bank. Demand for $7187.86 was made on the Reserve Bank by the Receiver on February 19th, 1927. Demand for $14,900.62 was made on May 11, 1927. These demands were refused. Interest therefore becomes calculable at the legal rate prevailing in Virginia,—6% per annum,—on $7187.86 from February 19, 1927 and on $14,900.62 from May 11, 1927. The surrender value of the stock in the Reserve Bank as of date May 20th, 1927, was $4115.15.

The counter-claim of defendant is based on items in transit that were being handled by the Reserve Bank for collection. They were received for deferred credit, under regulations and check collection circulars which provide that the Reserve Bank will act only as agent for the bank from which it receives such checks. The items cannot be regarded as the property of the Reserve Bank. The circumstances shown in respect to the counter-claim make it clearly apparent that the claims upon which the suit is brought, and the claim set out by defendant in its counter-claim, do not arise between the parties in the

same capacity. The Reserve Bank has the right to file a general claim, as agent of the owners of the collection items in such amount as it may be advised; and it will be entitled, as such agent, to dividends on the claim established, in the same manner as dividends may be paid by the receiver on other claims filed against the insolvent bank.

It is therefore

ORDERED AND ADJUDGED, That defendant's counter-claim be dismissed, and that plaintiff have judgment against and do recover from the defendant: (1) On the first cause of action; The sum of $22,088.48, with interest $1417.38, aggregating in amount $23,505.86; (2) (15) On the second cause of action; The sum of $4115.15, with interest $239.34, aggregating in amount $4354.49.

ERNEST F. COCHRAN,
U. S. District Judge.

Charleston, S. C.
May 9th, 1928.

JUDGMENT

(16) Filed May 9, 1928.

UNITED STATES OF AMERICA,
Eastern District of South Carolina.
In the District Court.

Thos. A. Early, as Receiver of the Farmers and Merchants National Bank of Lake City, S. C., a national banking association, Plaintiff.

against

The Federal Reserve Bank of Richmond, a banking corporation duly organized under the Federal Reserve Act, Defendant.

This action having been brought to a trial at a District Court held on the Ninth day of May, A. D. 1928, and an Order of Judgment for the Plaintiff having been rendered therein by the Court, for the sum of Twenty-seven thousand eight hundred and sixty and 35/100 ($27,860.-35) dollars, and the costs having been adjudged at thirty-five and no/100 ($35.00) dollars;

Now, on motion of R. E. Whiting, Esq., Attorney for said Plaintiff;

IT IS ADJUDGED, that plaintiff, Thos. A. Early, Receiver as aforesaid, recover of said defendant, The Federal Reserve Bank of Richmond, Twenty-seven thousand eight hundred and sixty and 35/100 ($27,860.35) dollars, so found, with thirty-five and no/100 ($35.00) dollars costs.

R. E. WHITING,
Plaintiff's Attorney.

RICHARD W. HUTSON,
C. D. C. U. S. E. Dist. S. C.

(Seal)

May 9, 1928.

BILL OF EXCEPTIONS

(17) Filed May 9, 1928.

BILL OF EXCEPTIONS NO. 1

Be it remembered that at the trial of this action, a jury having been waived by a written stipulation filed with the Clerk of this court, and all issues submitted to the court for trial and determination, upon the stipulation and agreed statement of facts filed with such stipulation, the plaintiff and defendant to maintain the issues made by their pleading offered in evidence the above mentioned stipulation and agreed statement of facts and the exhibits attached thereto, which stipulation and agreed statement of facts was as follows, to-wit:

"Come now counsel for plaintiff and counsel for defendant and agree upon the facts hereinafter set forth, and stipulate that the same may be filed and considered as evidence in this cause:

STATEMENT OF FACTS

1. The Federal Reserve Bank of Richmond is and was at all times hereinafter mentioned a banking corporation, duly organized under the Federal Reserve Act, having its chief office in Richmond, Virginia, and the district, or territory, assigned to it included the State of South Carolina.

2. The Farmers and Merchants National Bank of Lake City was at all times herein mentioned a National banking association duly organized under the National Bank Act, and was a member of the Federal Reserve System, and had its office in Lake City, South Carolina, until it was closed and placed in liquidation as stated herein.

3. The Federal Reserve Bank of Richmond had for sometime prior to the closing of the Farmers and Merchants National Bank of Lake City received from banks which were members of the Federal Reserve System and other Federal Reserve Banks checks drawn upon the Farmers and Merchants National Bank of Lake City. All of the said checks were received in accordance with, and subject to the terms of Regulation J, series of 1924, (18) duly made and promulgated by the Federal Reserve Board a copy of which is hereto attached, marked Exhibit 1, and made a part hereof, and with circular No. 143 issued by the Federal Reserve Bank of Richmond, a copy of which is hereto attached marked Exhibit 2, and made a part hereof and with the time schedule issued by the Federal Reserve Bank of Richmond, marked Exhibit 3, a copy of which is hereto attached and made a part hereof.

4. A copy of the said circular No. 143 had been sent to the Farmers and Merchants National Bank of Lake City, and receipt thereof had been acknowledged by the Farmers and Merchants National Bank of Lake City be-

fore the times hereinafter mentioned, a copy of which acknowledgment is hereto attached Marked Exhibit 4, and made a part hereof.

5. In accordance with said Regulation J and said Circular No. 143 it had been the practice of the Federal Reserve Bank of Richmond to send on each business day to the Farmers and Merchants National Bank of Lake City checks drawn upon it, which had been received by the Federal Reserve Bank of Richmond as above stated, and when three business days had elapsed after the dispatch of a letter containing such checks to charge the amount thereof to the reserve account maintained by the Farmers and Merchants National Bank of Lake City with the Federal Reserve Bank of Richmond. If the Farmers and Merchants National Bank of Lake City was willing to accept and pay such checks it retained them and charged them to the accounts of the drawers. If it was unwilling to pay any or all of such checks, it returned such of them as it was unwilling to pay after causing them to be duly protested, if protest was requested, and the amount of all checks so returned was credited to the account of the Farmers and Merchants National Bank of Lake City.

6. In the course of conducting business as stated above, the Federal Reserve Bank of Richmond did not disclose to the Farmers and Merchants National Bank of Lake City the names of persons from whom the checks had been received except insofar as this knowledge could be obtained from endorsements appearing upon the (19) checks. When such checks were sent to the Farmers and Merchants National Bank of Lake City, a memorandum account of the amount thereof was kept by the Federal Reserve Bank of Richmond, and when the said three business days had elapsed the amount of all such checks was charged by the Federal Reserve Bank of Richmond on its books to the reserve account of the Farmers and Merchants National Bank of Lake City. When such checks were received by said Farmers and Merchants National Bank, a memorandum account thereof was kept by said bank, and when three business days from the date of the letter of transmission had elapsed, the amount of such checks as had been charged to the

accounts of the drawers of same in said Bank were credited to the said Federal Reserve Bank on the books of said Farmers and Merchants National Bank in the reserve account it carried with the said Federal Reserve Bank.

7. On Thursday, October 7, 1926, the Federal Reserve Bank of Richmond sent to the Farmers and Merchants National Bank of Lake City subject to the provisions of said Regulation J and Circular No. 143 a letter containing checks which had been received by it subject to the provisions of said Regulation J and Circular No. 143, said checks being drawn upon the said Farmers and Merchants National Bank amounting to $14,934.12. A copy of said letter of October 7, 1926, is hereto attached, marked Exhibit 5 and made a part hereof. The said letter and checks were received by the Farmers and Merchants National Bank of Lake City on October 8, 1926, and the usual slip or receipt attached to such letter was mailed by the Farmers and Merchants National Bank of Lake City to the Federal Reserve Bank of Richmond on October 8, 1926, and the usual slip or receipt attached to such letter was mailed by the Farmers and Merchants National Bank of Lake City to the Federal Reserve Bank of Richmond on October 8th. A copy of said slip, or receipt, is hereto attached, marked Exhibit 6 and made a part hereof. On October 8, 1926, the Farmers and Merchants National Bank cancelled checks contained in the said letter amounting to Fourteen Thousand Nine Hundred Dollars and Sixty-two Cents ($14,900.62), and charged them to the accounts of the drawers and returned unpaid checks amounting to Thirty-three Dollars (20) and Fifty Cents ($33.50). After the close of business on October 9, 1926, said Farmers and Merchants National Bank suspended, and notice of said suspension was received by said Federal Reserve Bank on October 10th as more fully hereinafter set forth in paragraph 12 hereof. On October 11, 1926 the Federal Reserve Bank of Richmond charged the reserve account of the Farmers and Merchants National Bank of Lake City with the amount of all checks contained in the above mentioned letter of October 7th, and thereupon on that day credited the amount of such checks to the banks from which they had been received in accordance with the provisions of

Regulation J and Circular No. 143. The checks, totalling Thirty-three Dollars and Fifty Cents ($33.50), which had been sent in the said letter were returned unpaid to the Federal Reserve Bank of Richmond, and the amount of such checks was credited to the Farmers and Merchants National Bank of Lake City and charged to the banks from which they had been received.

8. At the opening of business on October 11th the Federal Reserve Bank of Richmond had to the credit of the Farmers and Merchants National Bank of Lake City in its reserve account the sum of Twenty-two Thousand and Eighty-five Dollars and Fifty-two Cents ($22,085.52), and after the said Federal Reserve Bank had made bookkeeping entries charging the amount of the letter of October 7th and crediting the amount of certain checks, which were returned unpaid, at the close of business on October 11th there appeared on the books of said Federal Reserve Bank in the reserve account of the Farmers and Merchants National Bank of Seven Thousand Two Hundred and Thirty-five Dollars and Six Cents ($7,235.06).

9. On Friday, the 8th day of October 1926, the Federal Reserve Bank of Richmond sent to the Farmers and Merchants National Bank of Lake City, subject to the provisions of Regulation J and Circular No. 143 a letter containing checks which had been received by the Federal Reserve Bank subject to the provisions of Regulation J and Circular No. 143 amounting to Twenty-one Thousand and Forty-one Dollars and Two Cents ($21,041.02), (21) a copy of which letter is hereto attached, marked Exhibit 7 and made a part hereof. This letter was received by the Farmers and Merchants National Bank of Lake City on the 9th day of October 1926, and upon that day the Farmers and Merchants National Bank of Lake City mailed to the Federal Reserve Bank of Richmond the usual slip, or receipt a copy of which is hereto attached, marked Exhibit 8 and made a part hereof, and on the 9th day of October, 1926, checks contained in the said letter amounting to Twenty Thousand, One Hundred and Seventy Dollars and Seventy-one Cents ($20,170.71) were cancelled and charged to the accounts of the drawers thereof by the Farmers and Merchants National Bank, and checks amounting to Eight Hundred and

Seventy Dollars and Thirty-one Cents ($870.31) were returned unpaid to the Federal Reserve Bank of Richmond.

10. On Tuesday the 12th day of October, 1926 the said Federal Reserve Bank charged the amount of the checks contained in the letter of October 8th to the reserve account of the Farmers and Merchants National Bank, but having on October 11th charged the letter of October 7th to the said reserve account of said Farmers and Merchant National Bank, the balance appearing in said reserve account by reason of said charge was Seven Thousand Two Hundred and Thirty-five Dollars and Six Cents ($7,235.06) and was insufficient to care for said checks of said letter of October 8th, and said reserve bank charged the various items included in the letter of October 8th to the banks from which they had been received and on the same day the charge against the account of the said Farmers and Merchants National Bank was reversed; thereupon the said Reserve bank advised said banks against which said items had been charged back that actual and final payment for such checks had not been received from the Farmers and Merchants National Bank of Lake City and later the Federal Reserve Bank of Richmond notified such banks to which such checks had been charged that it was holding the sum of Seven Thousand One Hundred and Eighty-seven Dollars and Eighty-six Cents ($7.187.86), which appeared to the credit of the Farmers and Merchants National Bank of Lake City in its reserve account, and that it would distribute the said sum as a part payment on account of the checks con-
(22) tained in the letter of October 8th if it appeared that such sum was applicable as a part payment on account of the checks contained in the letter of October 8th mentioned above. This amount was carried by said reserve bank in the reserve account of the Farmers and Merchants National Bank of Lake City until October 21st, 1926, at which time it was transferred to a special or suspense account, by said reserve bank, and the said sum is still held by the reserve bank pending the determination of this cause.

11. The difference between the said sums of $7235.06 and $7,187.86 mentioned in the preceding paragraph is due to certain entries made in the reserve account of the

Farmers and Merchants National Bank of Lake City denoting charges and credits concerning matters not involved in this controversy. A copy of the ledger of the said Federal Reserve Bank of Richmond showing said reserve account is hereto attached, marked Exhibit 9, and made a part hereof.

12. On Saturday, October 9, 1926, after the close of business the directors of the Farmers and Merchants National Bank of Lake City by formal action passed a resolution closing said bank on account of insolvency, and on Sunday, October 10th, Mr. P. H. Arrowsmith, Attorney for the Farmers and Merchants National Bank of Lake City sent to the Federal Reserve Bank of Richmond a telegram reading as follows:

"Farmers and Merchants National Bank Lake City closed last night trying to reorganize Monday morning will you send us Garrett to help."

The telegram was received at the office of the Federal Reserve Bank of Richmond at about 11:30 A. M. Sunday, October 10th, and the contents thereof were immediately communicated to Mr. John T. Garrett, Manager of the Bank Relations Department of the Federal Reserve Bank of Richmond, who left Richmond that night for Lake City, and arrived there on the morning of October 11th. The telegram was in the hands of the proper officers of the Federal Reserve Bank at the opening of business on October 11th. The Farmers and Merchants National Bank of Lake City was not reorganized, or reopened, and (23) on the 18th day of October the Comptroller of the Currency appointed Thos. A. Early as Receiver for the Farmers and Merchants National Bank of Lake City upon the ground that the bank was insolvent.

13. On October 11th, 1926 between 12:00 and 1:00 P. M. Garrett talked over the telephone to the Federal Reserve Bank of Richmond.

14. On October 21, 1926, the Federal Reserve Bank of Richmond sent to the receiver a statement showing that it had transferred the balance of Seven Thousand

One Hundred and Eighty-seven Dollars and Eighty-six Cents ($7,187.86) mentioned above to a suspense account, and was holding the same. Prior to May 11, 1927 the Receiver had, on to-wit, the 19th day of February 1927, demanded the payment to him of said sum of $7,187.86, and the question of the right of the defendant to charge against said reserve account the amount of the checks in the said letters of October 7, 1926, had not been given consideration, but on May 11, 1927, acting under instructions of the Comptroller of the Currency, the receiver demanded that the Federal Reserve Bank of Richmond pay over to him the amount charged to the reserve account of the Farmers and Merchants National Bank of Lake City on account of checks contained in the letter of October 7th in addition to the above mentioned balance of Seven Thousand One Hundred and Eighty-seven Dollars and Eighty-six Cents ($7,187.86). The attached letters constitute part of the correspondence between the receiver and the Federal Reserve Bank of Richmond, copies of which are hereto attached, marked Exhibits 10 to 15, and made a part hereof. Either party may also introduce, at the trial, any other letters constituting part of said correspondence, subject to objection.

15. The Farmers and Merchants National Bank of Lake City was a member of the Federal Reserve System and had subscribed for and been allotted 78 shares of the stock of the Federal Reserve Bank of Richmond, and had paid in on said subscription the sum of Thirty-nine Hundred Dollars ($3,900.00), and dividends at the rate of 6% from June 30, 1926 have accrued thereon and are unpaid. The Receiver surrendered to the Federal Reserve Bank of Richmond the above mentioned stock, and on the 20th day of May 1927, demanded the surrender (24) value thereof, and the sum of $215.15 representing said accrued dividends, but said Reserve Bank has refused to pay same to said Receiver.

16. That under date of May 28, 1927, said Reserve Bank sent to all banks whose checks were contained in letter of October 7th a circular letter dated May 23rd, 1927, which letter reads as follows:

May 23, 1927

"Gentlemen:

The items listed below were received in your cash letter as shown. We sent them to the Farmers and Merchants National Bank of Lake City, South Carolina in our letter of October 7, 1926. They were received by that bank on October 8th and cancelled and charged to the accounts of the drawers. Under our time schedule checks in our letter of October 7th were chargeable to the reserve account of the Farmers and Merchants National Bank on Monday, October 11th. On the night of Saturday, October 9th, the Farmers and Merchants National Bank was closed by order of its directors. You were notified of such action on October 10th. On October 11th the Farmers and Merchants National Bank had in its reserve account a balance sufficient to cover the letter of October 7th; therefore we charged the amount of this letter to the reserve account and credited you with the amount of your items which were in the letter.

Recently the Receiver of the failed bank, acting by direction of the Comptroller of the Currency, notified us that it was the view of the Comptroller of the Currency that, since the Farmers and Merchants National Bank closed before the letter of October 7th was charged to its reserve account, we had no right to apply the reserve account, or any part of it, to the payment of checks contained in this letter. Accordingly the Receiver demanded that we should pay over to him the amount of the reserve account as shown on our books on the day that the Farmers and Merchants National Bank closed, and file a claim for the amount of the cash letter.

We have refused this demand, and the Receiver has stated that he is instructed to bring suit against us to recover the balance claimed by him. We shall defend this suit, but we are compelled to notify you that since the checks listed below were received by us as your agent, if we are compelled to refund the money collected upon them, we shall be compelled to charge the amount to your account.

Very truly yours,

EDW. WALLER, JR.,
Asst. Cashier.

17. Any party hereto may introduce, refer to, or rely upon, subject to objection, any letters exhibits or any (25) regulation of the Federal Reserve Board duly promulgated at the times mentioned above and all of such regulations so far as are in any way applicable to the above mentioned transactions shall be deemed a part of this stipulation.

(sgd) R. E. WHITING,
_____,
Attorneys for Receiver, Farmers and Merchants National Bank, Lake City, South Carolina.

(sgd) M. G. WALLACE,
Attorney for Federal Reserve Bank of Richmond."

EXHIBITS 1 TO 9

(Memorandum: In accordance with the stipulation of counsel the printing of these exhibits is omitted.)

EXHIBIT 10

(44) October 27, 1926

Federal Reserve Bank
Richmond, Va.

Gentlemen:

We are in receipt of your statement as of October 15, 1926 showing a balance in the amount of $7,187.86. This does not agree with our records with the following exceptions.

Our return item of October 9th amounting to $83.70. You forward credit advice as of October 11th. On October 14th you debit our account with this item, but do not return to us.

Our return item of October 11th amounting to $736.14. You forward credit advice as of October 12th. On Octo-

ber 14th you debit our account with this item, but do not return to us.

Our return item of October 11th amounting to $85.77. You credit our account October 13th. On October 14th you debit our account with this item, but do not return the item.

On October 12th you show a debit of a cash letter amounting to $21,041.02. Our records show that this letter has been entered and the checks charged to the depositors' accounts.

On October 14th you credit our account with three items—$10.00, $15.00, and $8.50, please give us a description of these items.

Therefore, according to our reconcilement, we show a balance due by you in the amount $8,093.47 against a balance due to you in the amount of $21,041.02.

Yours very truly,

(Signed) THOS. A. EARLY.
Receiver.

Nss

EXHIBIT 11

FEDERAL RESERVE BANK OF RICHMOND

October 29, 1926

C O P Y

Mr. Thomas A. Early, Receiver,
Farmers and Merchants National Bank,
Lake City, S. C.

Dear Sir:

Reference is made to your letter of October 27th regarding our statement of October 15th of the reserve account of the Farmers and Merchants National Bank.

With reference to cash letter for $21,041.02, we wish to advise that this amount was charged to the reserve ac-
(45) count on October 12th as stated by you. However, the balance in the reserve account was insufficient and

consequently it was necessary for us to charge the items to our respective endorsers with a view of filing a claim in their behalf for such items. To offset the debits to the endorsers our charge to the Farmers and Merchants National Bank had to be reversed, which accounts for our credit for the same amount on the same date.

The entries of October 12th for $21,041.02 represent our cash letter of October 8th. On the 12th we credited a return letter of $736.14, which we reversed on the 14th. This return letter covered items for $33.90, $600.00 and $100.44, plus protest fees of $1.80. The three cash items were included in our letter of October 8th and since the entire cash amount of the cash letter had been credited to you, we were in error in crediting the return items, and you will note that after reversing on the 14th our credit of the 12th for $736.14 we then credited $1.80 representing protest fees. On October 13th we credited a return item for $85.77, representing a return letter containing items for $7.49, $9.63 and $68.64. All of these items were listed in our cash letter of the 8th and consequently we were in error in giving credit for the return letter, since the amounts were included in our letter of October 12th for $21,041.02. Therefore, on October 14th we charged the Farmers and Merchants National Bank with $85.77 to reverse our credit of the 13th.

On October 11th we credited the Farmers and Merchants National Bank with a return letter of $83.70 containing items for $46.17, $1.25, $2.78, $15.00, $10.00 and $8.50. It was found that of the six items included in this return letter the first three were listed in our cash letter of October 8th and were included in our credit of October 12th, while the last three were listed in our cash letter of a previous date. Therefore, on the 14th we charged the Farmers and Merchants National Bank $83.70 to reverse our credit of the 11th and credited $15.00, $10.00 and $8.50 representing the three items that were listed in our cash letter prior to October 8th.

We believe that with the above explanation of the correcting entries, which were made in connection with return items that had been listed in the cash letter for which we propose to file a claim, you will be able to reconcile our balance. If, however, you are unsuccessful, and will send us a transcript of the account as shown on the books of the Farmers and Merchants National Bank of

Lake City, S. C., subsequent to October 11th, we will be very glad to render you all assistance possible.

Yours very truly,

(Signed) C. L. GUTHRIE, Manager,
Adjustment-Transfer Department

CLG:

EXHIBIT 12

(46) FEDERAL RESERVE BANK
OF RICHMOND

December 4, 1926

Mr. Thos. A. Early, Receiver,
Farmers & Merchants National Bank
Lake City, S. C.

Dear Sir:

I hand you herewith a proof of claim for the amount due by the Farmers & Merchants National Bank of Lake City to the Federal Reserve Bank of Richmond in settlement for a cash letter which was sent by the Federal Reserve Bank of Richmond to the Farmers and Merchants National Bank of Lake City.

As you know, the checks have been received by us for collection in accordance with the regulations of the Federal Reserve Board, and, therefore, the member banks and other persons who had deposited these checks for collection, are the equitable owners of this claim, but if the claim appears upon your books as due to the Federal Reserve Bank of Richmond, the Comptroller of the Currency has in other cases permitted the claim to be filed by us as a single claim; because this rendered the payment of dividends much more simple than it would be if a claim was filed upon each individual check in the letter.

You will notice that we have deducted from the amount

of our claim one check for $8.80. As stated in the proof of claim we received this check from the National Bank of Commerce in New York. They tell me that they do not wish a claim filed upon this check, so I presume that they and their customer have been reimbursed; consequently if the drawer of this check desires to file a claim in his own name it will be satisfactory to us. We have no other description of the check except that given, but if it is necessary to complete your record, we will endeavor to obtain it.

If upon inspection you find that our claim is in proper form, I will be obliged if you will issue to us a Receiver's certificate, and if it is practicable to do so at this time, I would like to have your rough estimate of the amount which will be paid as dividends by this trust. I know, of course, that any accurate estimate would be impossible, but I would like to have your best guess.

Very truly yours,

(signed) M. G. WALLACE,
Counsel.

MGW:IB

(47) THE FARMERS & MERCHANTS NATIONAL BANK OF LAKE CITY, S. C.

PROOF OF CLAIM

State of Virginia,
City of Richmond, ss:

Personally appeared before me, the undersigned, a Notary Public in and for said county and State, George H. Keesee, Cashier of the Federal Reserve Bank of Richmond, who being duly sworn, says that the Farmers & Merchants National Bank of Lake City, South Carolina is justly indebted to Federal Reserve Bank of Richmond as trustee for various of its depositors in the sum of Twelve thousand nine hundred and seventy-four dollars and five cents, upon the following, claim, to-wit:

Checks in cash letter from Federal Reserve Bank of Richmond dated October 8, 1926	$20,170.71	
Less reserve balance of Farmers and Merchants National Bank, Lake City with Federal Reserve Bank of Richmond...	7,187.86	
		12,982.85
Less and item for $8.80 received by Federal Reserve Bank of Richmond from National Bank of Commerce, New York	8.80	
		$12,974.05

Balance due on Savings Account..... ——— 66
Unremitted Collection No. —— ..... ——— ———

All of which is due and payable to Federal Reserve Bank of Richmond as above, having given no indorsement or assignment of the same or any part thereof, and Geo. H. Keesee, Cashier further says that....know of no set-off or other legal or equitable defense to said claim, or any part thereof.

Name Geo. H. Keesee

Address Federal Reserve Bank of Richmond

Sworn to and subscribed before me this 3rd day of December, A. D. 1926.

Witness my hand and notarial seal.

M. G. WALLACE,
Notary Public.

(48) **EXHIBIT 13**

FEDERAL RESERVE BANK
OF RICHMOND

January 17, 1927.

Mr. Thos. A. Early, Receiver
Farmers & Merchants National Bank
Lake City, S. C.

My Dear Mr. Early:

I have before me your letter of December 24, 1926 upon the subject of the application of the balance in the reserve account of the Farmers & Merchants National Bank of Lake City to our cash letter of October 8th.

In making the application of this balance, we are not in the strict sense of the word making an offset—that is we are not setting off against each other two claims arising out of independent transactions, but are applying to the partial payment of a claim a fund placed in our hands for the purpose of paying the claim.

Paragraph 4 of Section 5 of Regulation J issued by the Federal Reserve Board concerning the collection of checks is as follows:

"Checks received by a Federal reserve bank on its member or nonmember clearing banks will ordinarily be forwarded or presented direct to such banks, and such banks will be required to remit or pay therefor at par in cash or bank draft acceptable to collecting Federal reserve bank, or at the option of such Federal reserve bank to authorize such Federal reserve bank to charge their reserve accounts or clearing accounts; provided, however, that any Federal reserve bank may reserve the right in its check collection circular to charge such items to the reserve account or clearing account of any such bank at any time when in any particular case the Federal reserve bank deems it necessary to do so."

You will see from the above that the Federal Reserve

Board requires a member bank to authorize each Federal Reserve Bank to charge checks to the reserve account of the member bank.

In our collection circular it has always been understood between this Federal Reserve Bank, and the member banks of this District that we would not expect, or require them to remit us by draft in payment of cash letters, but would charge these cash letters to their reserve account, clearing the checks contained in the cash letters in this way.

This has been made clear in our circulars dealing with the collection of checks—the latest of which, No. 143, a copy of which is herewith enclosed, reads in part as follows:

"Checks received by us drawn on our member banks will be forwarded in cash letters direct to such banks and each member bank will be required to either remit therefor in immediately available funds or to provide funds available to us to meet such cash letters within the agreed transit time to and from the member bank. Therefore, the amount of any cash letter to a member (49) bank is chargeable against available funds in the reserve account of such member at the expiration of such transit time, which date will be shown on each cash letter. The right, is reserved, however, to charge a cash letter to the reserve account of a member bank at any time when in any particular case we deem it necessary to do so."

It seems to me that under the regulations of the Board, and under our circulars that as soon as a member bank cancels a check drawn upon itself, and sent to it by us, it becomes responsible for the payment of that check, and since the check was sent to it upon the faith of its reserve balance, and upon the understanding that its reserve balance would be chargeable with the amount of the checks, then our right to charge the amount of the checks to the reserve balance is absolute.

If the reserve balance had been equal to, or had exceeded, the amount of our cash letter, the propriety of charging the cash letter to the reserve balance would not have been open to the slightest question. It would have been done in the ordinary course of routine business, and

the matter would have been closed just as any payment through a clearing house is closed. I can see no reason why the rule should be different in a case in which the balance is not equal to the amount of the cash letter. In other words, it is the duty of the member bank to place in our hands a balance sufficient to cover the cash letter, but it could not claim a benefit from its own default, and take the position that by failing to pay in full, it deprived the holder of the check of the right to apply a part payment. You, of course, stand in the shoes of the member bank, and can assert only such rights as it might have asserted, and it, therefore, seems to me that you can make no objection to our application of the balance when such objection is based upon the fact that the member bank failed to place us in funds to pay the entire letter.

In other words, the application is not made under any theory of an offset allowed by statute, or by the rules of equity, but in strict application of the contract under which the checks were sent to the member bank.

I find few decided cases upon this subject. In fact, the precise question appears to have been presented in only one case—that is to say in Federal Reserve Bank of Minneapolis v First National Bank, 277 Fed. Rep. 300, a digest of which you will find in the Digest of Decisions Relating to National Banks for the years 1921-24, issued by the Comptroller of the Currency at page 92.

In discussing the particular point under consideration, the court says (277 Fed. Rep. P. 304.):

"From the time of the promulgation of this rule (Regulation J) the credit of a member bank with its Federal Reserve Bank was rightfully treated by the Reserve Bank as a fund to cover all checks received from or for its account by a member bank. Indeed, if this Reserve Bank, as a clearing house was to be made practical, if it were to be made possible for the banks to deal with it with any safety, the deposit account of this defendant bank must necessarily be treated as a fund to make good the balances in the clearing against defendant."

It seems to me that the above decision, and the plain words of the regulations of our circular, leave our rights

in this matter in no doubt, but if you still have doubt in the matter I will be glad if you will let me hear from you.

Very truly yours,

(Signed) M. G. WALLACE,
Counsel.

MGW:IB

(50) **EXHIBIT 14**

FEDERAL RESERVE BANK
OF RICHMOND

February 7, 1927.

Mr. Thos. A. Early, Receiver
Farmers & Merchants National Bank
Lake City, S. C.

Dear Sir:

I enclose you herewith a corrected proof of our claim against the failed bank.

Yours very truly,

(Signed) M. G. WALLACE,
Counsel.

MGW:IB

THE FARMERS & MERCHANTS NATIONAL BANK OF LAKE CITY, S. C.

PROOF OF CLAIM

State of Virginia,
City of Richmond, ss.

Personally appeared before me the undersigned, a Notary Public in and for said county and State, George

H. Keesee, Cashier of the Federal Reserve Bank of Richmond, who being duly sworn, says that the Farmers & Merchants National Bank of Lake City, South Carolina is justly indebted to Federal Reserve Bank of Richmond as trustee for various of its depositors in the sum of Twelve Thousand Nine Hundred and Eighty-Two dollars and Eighty-five cents, upon the following, claim, to-wit:

Checks in cash letter from Federal Reserve Bank of Richmond dated October 8, 1926	$20,170.71
Less reserve balance of Farmers and Merchants National Bank, Lake City with Federal Reserve Bank of Richmond...	7,187.86
	12,982.85

All of which is due and payable to Federal Reserve Bank of Richmond as above, having given no indorsement or assignment of the same or any part thereof, and Geo. H. Keesee, Cashier, further says that know of no set-off or other legal or equitable defense to said claim, or any part thereof.

Name Geo. H. Keesee, Cashier

Address Federal Reserve Bank of Richmond

Sworn to and subscribed before me this 3rd day of February, A. D. 1927.

Witness my hand and notarial seal.

M. G. WALLACE,
Notary Public.

(51) **EXHIBIT 15**

February 19, 1927

Mr. M. G. Wallace,
Federal Reserve Bank of Richmond,
Richmond, Va.

Dear Sir:—

The matter of your claim of about $12,000.00 against the Farmers and Merchants National Bank of Lake City, S. C., and your refusal up to this date to pay me the balance of the $8,059.97 held by the Federal Reserve Bank of Richmond and to sell and send the proceeds of the stock of this bank in the Federal Reserve Bank has been submitted to the Comptroller of Currency for consideration and instruction. We have also submitted copies of the correspondence and a detail of all the facts.

After careful study of the case, the office of the Comptroller has ruled that in as much as the Federal Reserve Bank has charged the items included in their second cash remittance letter of October 8, 1926 for $21,041.02 against the accounts of their respective member banks, then it is incumbent upon the Federal Reserve Bank to deliver to me this balance of $8,059.97 and to pay to me as receiver the proceeds of the capital stock of the Federal Reserve Bank which is held by this trust together with accrued dividends. In this event, the Federal Reserve Bank should be permitted to prove a claim of $21,041.02 as agents of the owners of the items covered by the second remittance letter.

The Comptroller's office did not take into consideration however, the return items included in your letter of $21,041.02. After deducting these items your balance would be $7,187.86 due the Farmers & Merchants National Bank. The proper settlement would be for the Federal Reserve Bank to pay to this trust the balance of $7,187.86 and the proceeds of the capital stock and accrued dividends. Then, file claim for your letter of $21,041.02 less the return items herein referred to.

The attorneys for this trust have given this case careful consideration and they are of the opinion that the

ruling of the Comptroller is in accordance with the law governing such cases.

Please advise at once whether you agree to this settlement.

Thanking you, I am

Very truly yours,

(Signed) THOS. A. EARLY,
Receiver.

TAE:L

Whereupon the plaintiff read in evidence Regulation (52) D, of the Series of 1924, duly promulgated by the Federal Reserve Board, and likewise read in evidence Regulation J, Series of 1920, duly promulgated by the Federal Reserve Board, which two Regulations are as follows:

(Memorandum: In accordance with the stipulation of counsel the printing of these Regulations is omitted.)

Neither party offered any other or further evidence.

Whereupon the plaintiff moved the court to find the (59) facts as set forth in the said stipulation and agreed statement of facts, and to rule and hold as a matter of law that upon the facts so established and found the plaintiff was entitled to recover from the defendant the amount demanded in his complaint upon the first and second causes of action; and to rule and hold as a matter of law that upon the facts so established and found the defendant was not entitled to offset or apply the demands set forth in its affirmative defense and counter-claim upon the amounts due by the defendant to the plaintiff on his first and second causes of action; and to enter judgment for the plaintiff against the defendant upon the first and second causes of action, as prayed in the complaint.

And the defendant moved the court to find the facts to be as stated in the said stipulation and agreed statement of facts, and moved the court to rule and hold as a matter of law that on the facts so established and found the plaintiff was not entitled to recover anything of the de-

fendant upon either the first or second causes of action; and to rule and hold as a matter of law that on the facts so established and found the defendant was entitled to establish a claim against the Farmers and Merchants National Bank of Lake City, as prayed in the affirmative defense and counter-claim; and moved the court to enter judgment for the defendant and against the plaintiff, establishing such claim and directing the plaintiff to certify to the Comptroller of the Currency as a proper claim against the Farmers and Merchants National Bank of Lake City the amount demanded by the defendant in its affirmative defense and counter-claim.

Whereupon the court found the facts to be as set forth in the stipulation and agreed statement of facts, and adopted paragraphs one to sixteen, inclusive, of the said stipulation and agreed statement of facts as special findings of fact by the court; and found as a matter of fact that Regulation J, Series of 1920, which is set forth above, was duly promulgated by the Federal Reserve Board until duly superseded by Regulation J, Series of 1924; and further found as a fact that Regulation D, Series of 1924, was duly promulgated and in force when the transactions in this suit took place.

And upon the facts so found the court ruled and held (60) as a matter of law that the plaintiff was entitled to recover of the defendant, both upon the plaintiff's first and second causes of action, the amount demanded in the complaint, to which ruling the defendant duly excepted.

And the court further ruled and held as a matter of law that the defendant was not entitled to set off or apply the claims and demands set forth in the affirmative defense and counter-claim against the amounts due by the defendant upon the plaintiff's first and second causes of action; and ruled and held that the defendant was not entitled to establish a claim against the Farmers and Merchants National Bank of Lake City as prayed in its affirmative defense, to which ruling the defendant excepted.

And the court proceeded to enter judgment as appears

in the record, to the entry of which judgment upon the facts as found by the court the defendant excepted.

Whereupon the defendant tendered this, its bill of exceptions, and prayed that the same might be signed and sealed and made a part of the record, which was accordingly done this 9th, day of May 1928.

ERNEST F. COCHRAN,
Judge of the District Court of the United States for the Eastern District of South Carolina.

ASSIGNMENTS OF ERROR

(61) Filed May 9, 1928.

Comes now the Federal Reserve Bank of Richmond and makes the following assignments of error upon which it will rely in the prosecution of an appeal from the judgment entered in this action:

1. The District court erred in ruling and holding that as a matter of law upon the uncontradicted facts of this case as established by the stipulation and agreed statement of facts filed herein, and as found by the court, the defendant was liable to the plaintiff upon his first cause of action.

2. The District court erred in ruling and holding that as a matter of law upon the uncontradicted facts of this case as established by the stipulation and agreed statement of facts filed herein, and as found by the court, the defendant was liable to the plaintiff upon his second cause of action.

3. The District court erred in ruling and holding that as a matter of law upon the uncontradicted facts as established by the stipulation and agreed statement of facts filed herein, and as found by the court, the de-

fendant was not entitled to set off and apply the claims and demands set forth in its affirmative defense and counter-claim against the plaintiff on his first and second causes of action, and was not entitled to establish against the Farmers and Merchants National Bank of Lake City a claim for the amount demanded in its affirmative defense and counter-claim.

4. The District court erred in entering judgment for the plaintiff and against the defendant upon the facts as found by the court.

FEDERAL RESERVE BANK
OF RICHMOND

By Counsel

M. G. WALLACE.

NOTICE OF APPEAL

(62) Filed May 9, 1928.

NOTICE OF APPEAL

To Thos. A. Early, Receiver of the Farmers and Merchants National Bank of Lake City, plaintiff in the above entitled action.

Take notice that the undersigned defendant in the above entitled action appeals from the judgment entered by the District Court of the United States for the Eastern District of South Carolina for the plaintiff and against the defendant the 9th, day of May 1928, and upon every part of such judgment.

FEDERAL RESERVE BANK
OF RICHMOND.

By Counsel

M. G. WALLACE.

Due service of the above notice accepted and delivery

of a copy thereof acknowledged this 9th day of May 1928.

R. E. WHITING,
Attorney of record for Thos. A. Early, Receiver of the Farmers & Merchants National Bank of Lake City.

STIPULATION FOR CLERK TO PREPARE TRANSCRIPT

(63) Filed May 9, 1928.

It is hereby stipulated and agreed that the Clerk of this Court shall make up a transcript of the record in the above styled cause, and transmit the same to the Clerk of the United States Circuit Court of Appeals for the Fourth Circuit, at Richmond, Va.; and that it be printed under the supervision of the Clerk of that Court, in accordance with Rule 23.

M. G. WALLACE,
Counsel for Federal Reserve Bank of Richmond.

R. E. WHITING,
Counsel for Thos. A. Early, Receiver.

May 9th, 1928.

STIPULATION OF COUNSEL AS TO EXHIBITS

It is further stipulated and agreed that exhibits 1 to 9, inclusive, attached to and forming a part of the agreed statement of facts and Regulation D, Series of 1924, and Regulation J, Series of 1920, which are set forth in the bill of exceptions, need not be printed, but that copies of

such exhibits and documents shall be furnished to the Circuit Court of Appeals at the time of oral argument.

M. G. WALLACE,
Counsel for Federal Reserve Bank of Richmond.

R. E. WHITING,
Counsel for Thos. A. Early, Receiver.

STIPULATION FOR MAKING UP RECORD

(64) Filed May 9, 1928.

It is hereby stipulated and agreed that the following portions of the records and proofs in above entitled cause shall be copied in making a transcript for the record for use in the United States Circuit Court of Appeals:

1. The complaint of the plaintiff.
2. The answer and affirmative defense and counterclaim of the defendant.
3. The reply of the plaintiff.
4. The stipulation waiving a trial by jury.
5. The judgment of the court.
6. The defendant's bill of exceptions.
7. Stipulation for printing of the record under the supervision of the Clerk of the Circuit Court of Appeals, as provided by Rule 23.
8. This stipulation.
9. The memorandum required by Section 7 of Rule 14 of the Circuit Court of Appeals for the Fourth Circuit.

The stipulation and agreed statement of facts and the exhibits filed thereunder referred to by the stipulation waiving a trial by jury and in the judgment of the court and in the bill of exceptions, need not be copied but once in the transcript.

M. G. WALLACE,
Counsel for Federal Reserve Bank of Richmond.

R. E. WHITING,
Counsel for Thos. A. Early, Receiver of the Farmers & Merchants National Bank, Lake City.

(65) **MEMORANDUM**

Notice of Appeal filed May 9, 1928.

Petition for appeal filed May 9, 1928.

Order allowing appeal filed May 9, 1928.

Bond on appeal $250.00, conditioned for costs.

Obligors: Federal Reserve Bank of Richmond, as principal, and Fidelity and Deposit Company of Maryland, as surety.

Citation filed May 9, 1928.

Service accepted and acknowledged May 9, 1928.

CLERK'S CERTIFICATE

IN THE DISTRICT COURT OF THE UNITED STATES FOR THE EASTERN DISTRICT OF SOUTH CAROLINA.
AT LAW.

I, Richard W. Hutson, Clerk of the District Court of the United States for the Eastern District of South Car-

olina, do hereby certify, that the foregoing is a true and correct copy of the record and proceedings in the case of Thos. A. Early, as Receiver of the Farmers and Merchants National Bank of Lake City, S. C., plaintiff, against The Federal Reserve Bank of Richmond, defendant, together with the Judgment and all papers relating to the same as stipulated and agreed by counsel to constitute the record on appeal, and as appears by the original record now on file and of record in my office.

Given under my hand and seal of said Court, at Charleston, S. C., this 12th day of May, 1928.

RICHARD W. HUTSON,
(SEAL) C. D. C. U. S. E. Dist. S. C.

EXHIBIT #1.

(Effective May 9, 1924)

REGULATION J
Series of 1924.
(Superseding Regulation J of 1920)

CHECK CLEARING AND COLLECTION.

SECTION I. STATUTORY PROVISIONS.

Section 16 of the Federal Reserve Act authorizes the Federal Reserve Board to require each Federal Reserve Bank to exercise the functions of a clearing house for its member banks, and Section 13 of the Federal Reserve Act, as amended by the act approved June 21, 1917, authorizes each Federal Reserve Bank to receive from any non-member bank or trust company, solely for the purposes of exchange or of collection, deposits of current funds in lawful money, national-bank notes, Federal Reserve notes, checks and drafts payable upon presentation, or maturing notes and bills, provided such nonmember bank or trust company maintains with its Federal Reserve Bank a balance sufficient to offset the items in transit held for its account by the Federal Reserve Bank.

SECTION II. GENERAL REQUIREMENTS.

In pursuance of the authority vested in it under these provisions of law, the Federal Reserve Board, desiring to afford both to the public and to the various banks of the country a direct, expeditious, and economical system of check collection and settlement of balances, has arranged to have each Federal Reserve Bank exercise the functions of a clearing house and collect checks for such of its member banks as desire to avail

themselves of its privileges and for such nonmember State banks and trust companies as may maintain with the Federal Reserve Bank balances sufficient to qualify them under the provisions of section 13 to send items to Federal Reserve Banks for purposes of exchange or of collection. Such nonmember State banks and trust companies will hereinafter be referred to as nonmember clearing banks.

Each Federal Reserve Bank shall exercise the functions of a clearing house and collect checks under the general terms and conditions hereinafter set forth.

SECTION III. CHECKS RECEIVED FOR COLLECTION.

(1) Each Federal Reserve Bank will receive at par from its member banks and from nonmember clearing banks in its district, checks* drawn on all member and nonmember clearing banks, and checks drawn on all other nonmember banks which are collectable at par in funds acceptable to the Federal Reserve Bank of the district in which such nonmember banks are located.

(2) Each Federal Reserve Bank will receive at par from other Federal Reserve Banks, and from all member and nonmember clearing banks in other Federal Reserve Districts which are authorized to route direct for the credit of their respective Federal Reserve Banks, checks drawn on all member and nonmember clearing banks of its district, and checks drawn on all other nonmember banks of its district which are collectable at par in funds acceptable to the collecting Federal Reserve Bank.

(3) No Federal Reserve Bank shall receive on deposit or for collection any check drawn on any nonmember bank which cannot be collected at par in funds acceptable to the Federal Reserve Bank of the district in which such nonmember bank is located.

*A check is generally defined as a draft or order upon a bank or banking house, purporting to be drawn upon a deposit of funds, for the payment at all events of a certain sum of money to the order of a certain person therein named, or to him or his order, or to bearer, and payable on demnad.

SECTION IV. TIME SCHEDULE AND AVAILABILITY OF CREDITS.

(1) Each Federal Reserve Bank will publish a time schedule showing the time at which any item sent to it will be counted as reserve and become available for withdrawal or other use by the sending bank. For all checks received, the sending bank will be given immediate credit, or deferred credit, in accordance with such time schedule, and as provided below.

(2) For all such checks as are received for immediate credit in accordance with such time schedule, immediate credit, subject to final payment, will be given upon the books of the Federal Reserve Bank at full face value in the reserve account or clearing account upon day of receipt, and the proceeds will at once be counted as reserve and become available for withdrawal or other use by the sending bank.

(3) For all such checks as are received for deferred credit in accordance with such time schedule, deferred credit, subject to final payment, will be entered upon the books of the Federal Reserve Bank at full face value, but the proceeds will not be counted as reserve nor become available for withdrawal or other use by the sending bank until such time as may be specified in such time schedule, at which time credit will be transferred from the deferred account to the reserve account or clearing account subject to final payment and will then be counted as reserve and become available for withdrawal or other use by the sending bank.

SECTION V. TERMS OF COLLECTION.

The Federal Reserve Board hereby authorizes the Federal Reserve Banks to handle such checks subject to the following terms and conditions; and each member and nonmember clearing bank which sends checks to any Federal Reserve Bank for deposit or collection shall by such action be deemed (a) to authorize the Fed-

eral Reserve Banks to handle such checks subject to the following terms and conditions, (b) to warrant its own authority to give the Federal Reserve Bank such authority, and (c) to agree to indemnify any Federal Reserve Bank for any loss resulting from the failure of such sending bank to have such authority.

(1) A Federal Reserve Bank will act only as agent of the bank from which it receives such checks and will assume no liability except for its own negligence and its guaranty of prior indorsements.

(2) A Federal Reserve Bank may present such checks for payment or send such checks for collection direct to the bank on which they are drawn or at which they are payable, or in its discretion may forward them to another agent with authority to present them for payment or send them for collection direct to the bank on which they are drawn or at which they are payable.

(3) A Federal Reserve Bank may in its discretion and at its option, either directly or through an agent, accept either cash or bank drafts in payment of or in remittance for such checks and shall not be held liable for any loss resulting from the acceptance of bank drafts in lieu of cash, nor for the failure of the drawee bank or any agent to remit for such checks, nor for the nonpayment of any bank draft accepted in payment or as a remittance from the drawee bank or any agent.

(4) Checks received by a Federal Reserve Bank on its member or nonmember clearing banks will ordinarily be forwarded or presented direct to such banks, and such banks will be required to remit or pay therefor at par in cash or bank draft acceptable to the collecting Federal Reserve Bank, or at the option of such Federal Reserve Bank to authorize such Federal Reserve Bank to charge their reserve accounts or clearing accounts; provided, however, that any Federal Reserve Bank may reserve the right in its check collection circular to charge such items to the reserve account or clearing account

of any such bank at any time when in any particular case the Federal Reserve Bank deems it necessary to do so.

(5) Checks received by a Federal Reserve Bank payable in other districts will be forwarded for collection upon the terms and conditions herein provided to the Federal Reserve Bank of the district in which such checks are payable.

(6) The amount of any check for which payment in actually and finally collected funds is not received shall be charged back to the forwarding bank, regardless of whether or not the check itself can be returned.

SECTION VI. OTHER RULES AND REGULATIONS.

Each Federal Reserve Bank shall also promulgate rules and regulations not inconsistent with the terms of the law or of this regulation, governing the details of its check clearing and collection operations. Such rules and regulations shall be set forth by the Federal Reserve Banks in their letters of instruction to their member and non-member clearing banks and shall be binding upon any member or nonmember clearing bank which sends any check to such Federal Reserve Bank for collection or to any other Federal Reserve Bank for the account of such Federal Reserve Bank for collection.

FEDERAL RESERVE BOARD.

EXHIBIT #2.

CIRCULAR NO. 143
Effective July 1, 1926
(Superseding Circular No. 131)

FEDERAL RESERVE BANK OF RICHMOND
COLLECTION OF CHECKS.

To Member Banks of the Fifth Federal Reserve District:

This circular sets forth fully the terms and conditions under which deposits of cash items will be accepted by the Federal Reserve Bank of Richmond (or its Baltimore Branch) and supersedes our Circular No. 131 of June 15, 1923. It is entirely optional with member banks whether they will avail themselves of the check collection facilities of the Federal Reserve System, but all member banks are requested to familiarize themselves with the contents of this circular, since in any event we will collect checks drawn on all member banks and this circular likewise deals with the duties of banks to which cash items are sent.

All references to the Federal Reserve Bank of Richmond apply to the Baltimore Branch as well as to the Head Office. Member banks located in the territory assigned to the Baltimore Branch should deal with the Branch at Baltimore as heretofore; those in the territory of the Head Office should deal with the Head Office at Richmond.

ITEMS WHICH WILL BE RECEIVED.

The following items will be received under the conditions of this circular:

(1) Checks* drawn on banking institutions in the United States which are listed on the Par List issued by the Federal Reserve Board semi-annually and supplemented monthly.

(2) Checks and warrants drawn on the Treasurer of the United States.

ITEMS WHICH WILL NOT BE ACCEPTED AS CASH ITEMS.

The following classes of items will not be received by us as cash items and should not be sent to us in cash

*A check is generally defined as a draft or order upon a bank or banking house, purporting to be drawn upon a deposit of funds, for the payment at all events of a certain sum of money to a certain person therein named, or to him or his order, or to bearer, and payable instantly on demand.

letters. Such items should be sent to us only as non-cash items for credit when paid.

(1) Checks which cannot be collected at par; that is, checks drawn on banks which are not listed on the Par List of the Federal Reserve Board. Such items will not be received either as cash items under this circular or as collection items under our Circular No. 144, "Collection of Maturing Notes, Bills and Other Non-Cash Items."

(2) Checks not drawn on banking institutions or checks "Payable through" instead of being drawn on a bank, such as drafts on Auditors or Treasurers of railroads.

(3) Checks which have been previously presented and dishonored or protested.

(4) Checks or drafts with pass book, certificate, or any form of receipt attached.

(5) Checks bearing special instructions or requiring special handling.

(6) Certificates of deposit.

(7) All non-cash collection items as enumerated in our Circular No. 144 relative to "Collection of Maturing Notes, Bills and Other Non-Cash Items."

CONDITIONS UNDER WHICH ITEMS WILL BE RECEIVED.

Every bank sending checks or other cash items to the Federal Reserve Bank of Richmond, or to another Federal reserve bank direct for our account, by such act will be understood to have agreed to the terms and conditions of this circular and of Regulation J of the Federal Reserve Board.

Terms of Collection

Regulation J of the Federal Reserve Board prescribes the following terms and conditions under which all Federal reserve banks will handle checks for member and non-member clearing banks when received for deposit or collection:

"The Federal Reserve Board hereby authorizes the Federal reserve banks to handle such checks subject to the following terms and conditions; and each member and non-member clearing bank which sends checks to any Federal reserve bank for deposit or collection shall by such action be deemed (a) to authorize the Federal reserve banks to handle such checks subject to the following terms and conditions, (b) to warrant its own authority to give the Federal reserve banks such authority, and (c) to agree to indemnify any Federal reserve bank for any loss resulting from the failure of such sending bank to have such authority.

"(1) A Federal reserve bank will act only as agent of the bank from which it receives such checks and will assume no liability except for its own negligence and its guaranty of prior endorsements.

"(2) A Federal reserve bank may present such checks for payment or send such checks for collection direct to the bank on which they are drawn or at which they are payable, or in its discretion may forward them to another agent with authority to present them for payment or send them for collection direct to the bank on which they are drawn or at which they are payable.

"(3) A Federal reserve bank may in its discretion and at its option, either directly or through an agent, accept either cash or bank drafts in payment of or in remittance for such checks and shall not be held liable for any loss resulting from the acceptance of bank drafts in lieu of cash, nor for the failure of the drawee bank or any agent to remit for such checks, nor for the non-

payment of any bank draft accepted in payment or as a remittance from the drawee bank or any agent.

"(4) Checks received by a Federal reserve bank on its member or non-member clearing banks will ordinarily be forwarded or presented direct to such banks, and such banks will be required to remit or pay therefor at par in cash or bank draft acceptable to the collecting Federal reserve bank, or at the option of such Federal reserve bank to authorize such Federal reserve bank to charge their reserve accounts or clearing accounts; provided, however, that any Federal reserve bank may reserve the right in its check collection circular to charge such items to the reserve account or clearing account of any such bank at any time when in any particular case the Federal reserve bank deems it necessary to do so.

"(5) Checks received by a Federal reserve bank payable in other districts will be forwarded for collection upon the terms and conditions herein provided to the Federal reserve bank of the district in which such checks are payable.

"(6) The amount of any check for which payment in actually and finally collected funds is not received shall be charged back to the forwarding bank, regardless of whether or not the check itself can be returned."

CHECKS AND WARRANTS DRAWN UPON THE TREASURER OF THE UNITED STATES.

The Treasurer of the United States reserves the usual right of the drawee to examine, when received, all Government warrants and checks and to refuse payment thereon, and the Federal Reserve Bank of Richmond will handle such items in accordance with the provisions of Treasury Department Circular No. 176, as amended and supplemented May 15, 1922.

Method of Handling

(1) The Treasurer will return immediately any war-

rant or check, payment of which is refused on account of forged signature of drawer, insufficient funds, stoppage of payment, or any material defect discovered upon first examination. Such items will be charged back and returned to the depositing bank for immediate credit.

(2) In the event that any warrant or check which has been paid by the Treasurer is subsequently found to bear a forged endorsement, or to have been raised, or to bear any other material alteration or defect which was not discoverable upon first examination, a photographic copy of the warrant or check will be sent to the depositing bank, but its account will not be charged pending adjustment.

(3) In cases of warrants or checks bearing a forged signature of the drawer, not discovered upon first examination by the Treasurer, and in other cases where the Treasurer's right to reclaim is in question, the warrants or checks will not be charged to the account of the depositing bank but will be returned to it as collection items for adjustment.

AVAILABILITY OF PROCEEDS.

Such checks as are receivable for immediate availability in accordance with our current time schedule will be credited upon day of receipt, subject to final payment, in the reserve accounts of member banks, and the proceeds will then be available for reserve and checking purposes.

Such checks as are receivable for deferred availability in accordance with our current time schedule will be credited upon day of receipt in the deferred credit accounts of member banks, and at the expiration of the time specified in our current time schedule such credits will become available for reserve and checking purposes and will be transferred from the deferred accounts to the reserve accounts of the member banks, subject to final payment of the items.

Member banks must bear in mind that our time schedule is based upon the average time required for collection and, therefore, advices received from us show-

ing the availability of items cannot be considered as advices of actual payment on the date of availability. Items in all cases are credited subject to final payment in accordance with the paragraph, "Conditions Under Which Items Will Be Received" on page 2 of this circular.

PREPARATION OF CASH LETTERS.

All cash items sent to us should be sorted and listed on cash letters in accordance with the divisions of our current time schedule, using a separate letter for items of each separate availability; that is to say, items immediately available should be listed on one letter, items available one day after receipt should be listed on another letter, items available two days after receipt on another letter, and so on. This is important, since credit for the proceeds of any letter containing items of different availabilities will be deferred to the date of availability of the items contained therein requiring the longest time for collection according to our time schedule.

Indicate on cash letters, opposite the amount of each item, the name or transit number of the bank upon which each item is drawn.

ENDORSEMENT OF CHECKS.

All items sent to us must be endorsed, without restriction, to the order of any bank, banker or trust company; or to the order of the Federal Reserve Bank of Richmond (or Baltimore Branch). All prior endorsements must be guaranteed. The endorsements should be dated and should also contain the American Bankers Association transit number of the depositing bank.

UNIFORM INSTRUCTIONS.

The Federal Reserve Bank of Richmond will receive and forward checks as cash items under the conditions of this circular, subject only to the following uniform instructions:

(1) *Do not protest*-items of $10.00 or less.

(2) *Protest* dishonored items of $10.01 or over, except those bearing on their face the A. B. A. no protest symbol of the Federal reserve bank or of a preceding bank endorser.

(3) *Wire advice* of non-payment of all items of $500 or over.

All Federal reserve banks (and branches) will receive and handle checks as cash items only in accordance with these uniform instructions, and any contrary or special instructions noted on cash letters or attached to checks will be disregarded. If any member bank should desire to have any checks handled by the Federal Reserve Bank of Richmond or by any other Federal reserve bank under any instructions contrary to the uniform instructions given above, it will be necessary for such member bank to forward such checks as individual no-cash items, with the instructions noted in the letter of transmittal, for collection and credit when paid, in accordance with the terms of our Circular No. 144 of July 1, 1926.

TELEGRAPHIC COSTS.

All telegraphic costs pertaining to payment or nonpayment, or in connection with receiving or transmitting any other information or instructions, will be charged to the account of the depositing bank. All such telegrams to the depositing bank will be sent "Collect".

DIRECT ROUTING OF CASH LETTERS TO OTHER FEDERAL RESERVE BANKS AND BRANCHES.

Member banks will be permitted, under certain conditions and regulations, to route checks payable in other Federal Reserve Districts direct to the other Federal Reserve Banks and Branches of the districts in which the items are payable, for our account, provided permission to do so is first obtained from the Federal Reserve

Bank of Richmond. Member banks desiring to avail themselves of this privilege will write us for permission (if permission has not already been obtained) and, if granted by us, they will be advised in a separate letter giving full information and complete instructions.

INDIRECT ROUTING OF CHECKS.

In the interests of good banking, the indirect routing of checks will be discouraged and member banks will not be permitted to deposit with us, or send direct to other Federal Reserve Banks or Branches for our account, any checks payable in other Federal Reserve Districts, which bear the endorsement of banks located in other Federal Reserve Districts, in cases where it is evident that such checks have been routed indirectly.

OUR CASH LETTERS TO MEMBER BANKS.

Checks received by us drawn on our member banks will be forwarded in cash letters direct to such banks and each member bank will be required either to remit therefor in immediately available funds or to provide funds available to us to meet such cash letters within the agreed transit time to and from the member bank. Therefore, the amount of any cash letter to a member bank is chargeable against available funds in the reserve account of such member at the expiration of such transit time, which date will be shown on each cash letter. The right is reserved, however, to charge a cash letter to the reserve account of a member bank at any time when in any particular case we deem it necessary to do so.

A space has been provided on the face of each envelope in which our cash letters are forwarded for the use of member banks in reporting undue delays in the mails. Should any letter be unduly delayed in transit and not be received by the member bank in time for remittance to be made to reach us on the date the letter is chargeable to its reserve account, advice of such delay should be given us by filling in the information called for in the space provided on the face of the envelope in which such cash letter was received and the entire en-

velope should be returned to us promptly. Proper allowance will be made in the reserve account of the member bank.

A self addressed stamped envelope will be forwarded each day with our cash letters to member banks for their use in remitting to us and in returning the acknowledgment coupons attached to our cash letters. It is extremely important that each coupon be promptly signed or stamped by the receiving bank and *immediately* returned to us in the stamped envelope as an acknowledgment of receipt of the letter. Member banks may use this stamped envelope for making remittances, but in any event the coupon should be returned *immediately upon receipt.*

UNPAID ITEMS RETURNED BY MEMBER BANKS.

Unpaid items not subject to protest must be returned to us on day of receipt. Items held for protest must be returned to us not later than the day following that of receipt. In no case should an unpaid item be held for any purpose except for immediate protest. A slip should be attached to each return item showing plainly the reason for non-payment. Return items should be listed in a separate letter *containing only return items* and credit for such letters will be given upon receipt.

FEDERAL RESERVE DISTRICT NUMBERS ON CHECKS.

To facilitate the sorting and routing of checks by member banks and by Federal Reserve Banks, you are requested to have the figure "5" (signifying Federal Reserve District No. 5) printed in large skeleton type (1½ inches or more high) in the center of all check blanks on your bank. Checks drawn by your bank on banks in other Federal Reserve districts should have printed on them, in a similar manner, a large skeleton figure denoting the Federal Reserve district in which the bank on which they are drawn is located.

COLLECTABLE AT PAR THROUGH THE FEDERAL RESERVE BANK OF RICHMOND.

All member banks (and those non-member banks which agree to remit at par in acceptable funds to the Federal Reserve Bank of Richmond are entitled to have the words "collectable at par through the Federal Reserve Bank of Richmond" printed or stamped on their own checks and the checks drawn on them by their depositors. Attention is called to the desirability of availing of this privilege, since it is manifest that checks on those banks which agree to remit at par should have wider currency than checks not collectable at par through the Federal Reserve Banks.

Respectfully,

FEDERAL RESERVE BANK OF RICHMOND.

EXHIBIT #3.

FEDERAL RESERVE BANK OF RICHMOND

Fifth Federal Reserve District.

TIME SCHEDULE.

Schedule showing when proceeds of cash items on the Cities and States listed herein will become available for reserve and checking purposes, when sent to Federal Reserve Bank of Richmond for collection and credit in accordance with the terms and conditions of Circular No. 131, "Collection of Checks".

Effective June 15, 1923, until further notice.

THREE DAYS AFTER RECEIPT.

Cities	States—except Cities listed in first column
Dallas	Delaware
Houston	New Jersey
Kansas City, Kansas	New York
(Routed to Kansas City, Mo.)	North Carolina
Kansas City, Mo.	Pennsylvania
Little Rock	South Carolina
Memphis	West Virginia
Minneapolis	
New Orleans	
Oklahoma City	
Omaha	
St Paul	
(Route to Minneapolis)	

List all items in accordance with the divisions of this Time Schedule, using a separate letter for items of each separate availability; that is, items available immediately upon receipt should be listed on one letter, items available one day after receipt should be listed on another letter, items available two days after receipt on another letter, and so on. This is important, since credit for any letter containing items of different availabilities will be deferred to the date of availability of the items contained therein requiring the longest time for collection according to this schedule.

Indicate on cash letters, opposite the amount of each item, the name or transit number of the bank upon which the item is drawn.

Note—Our Time Schedule is based upon the average time required for collection; therefore, advices received from us showing the availability of items cannot be considered as advices of actual payment. Items in all cases are credited subject to final payment.

See following page for Deferred Time Table.

DEFERRED TIME TABLE.

The following table shows the method used by the

Federal Reserve Bank of Richmond in determining the day of availability of letters containing items for deferred credit in accordance with pages 2 and 3 of this Time Schedule.

When a letter is received by us on a day indicated in first column, credit will be deferred until the day opposite on the same line, according to whether such letter contained items available one day or two days or three days, etc., after receipt, according to our Time Schedule.

This table is based on actual business days, except where items, after receipt by us, are in transit on Sundays or holidays, in which case actual calendar days are counted in determining the day of availability. Items reaching destination on a Sunday or a holiday are not considered in transit on those days, as the bank to which we send them cannot handle them until the following day.

When Received on	1-Day Letters Available on	2-Day Letters Available on	3-Day Letters Available on	4-Day Letters Available on	5-Day Letters Available on	6-Day Letters Available on	8-Day Letters Available on
Monday	Tuesday.	Wednesday.	Thursday.	Friday.	Saturday.	Monday.	Wednesday.
Tuesday	Wednesday.	Thursday.	Friday.	Saturday.	Monday.	*Tuesday.	Wednesday.
Wednesday	Thursday.	Friday.	Saturday.	Monday.	*Tuesday.	Tuesday.	Thursday.
Thursday	Friday.	Saturday.	Monday.	*Tuesday.	Tuesday.	*Thursday.	Friday.
Friday	Saturday.	Monday.	*Tuesday.	*Wednesday.	*Thursday.	Thursday.	Saturday.
Saturday	Monday.	*Tuesday.	Tuesday.	Wednesday.	Thursday.	Friday.	Monday.

*Except items drawn on Federal Reserve Bank or Branch Cities which will be available one day earlier.
When date of availability falls on a legal holiday credit will be given on the next business day.

EXHIBIT #4.

FEDERAL RESERVE BANK OF RICHMOND,

Richmond, Va.

Gentlemen:

The undersigned member bank hereby acknowledges receipt of Circular No. 143, of the Federal Reserve Bank of Richmond, regarding the "Collection of Checks", effective July 1, 1926, setting forth the terms and conditions under which cash items as specified in the circular will be received for collection from the undersigned member bank by the Federal Reserve Bank of Richmond or by another Federal reserve bank for its account, which circular supersedes Circular No. 131 of June 15, 1923.

Yours very truly,

FARMERS & MERCHANTS NAT BANK.
Bank
Lake City, S. C.
Location

By R. H. McELVEN.
Cashier (Official Signature)

7-9-26
Date

T 36 **EXHIBIT #5.** No. 88443

68-3 FEDERAL RESERVE BANK OF RICHMOND 68-3

To
Farmers & Merchants Nat'l Bank, Dispatched Oct 7 1929

Lake City, Chargeable against available balance in Reserve account Oct 11 1926

67-239 S. C.

We enclose for collection the checks listed below. PROTEST dishonored items of $10.01 or over, except those bearing on their face this stamp { N. P. / 68-3 } or a similar stamp of a preceding bank endorser. Do not protest items of $10 or less. WIRE ADVICE of non-payment of *all items of* $500 *or over*, giving the date of our letter, the ENDORSEMENT IMMEDIATELY PRECEDING OURS, and the reason for non-payment. Please detach and return the accompanying coupon as acknowledgment, using "PAID" stamp in space provided.

FEDERAL RESERVE BANK OF RICHMOND.

(Checks listed aggregating in amount $14,934.12)

T 36 **EXHIBIT #6.**

FEDERAL RESERVE BANK OF RICHMOND

No. 88443

Your CASH LETTER
has been received and collected this day. Dated
Any unpaid items have been returned in a separate letter. Total,

Use "PAID" stamp (including date) in this space to acknowledge receipt.

Oct. 8, 1926

PAID

Farmers & Merchants National Bank
Lake City, S. C.

Farmers & Merchants Nat'l Bank,
Lake City,
S. C.

67-239 Oct 7 1926

14,934.12 Oct 11 1926

T 36 **EXHIBIT #7.** No. 88942

68-3 FEDERAL RESERVE BANK OF RICHMOND 68-3

To

Farmers & Merchants Nat'l Bank, Dispatched Oct 8 1926

67-239 Lake City, S. C. Chargeable against available balance in Reserve Account Oct 12 1926

We enclose for collection the checks listed below. PROTEST dishonored items of $10.01 or over, except those bearing on their face this stamp { N. P. / 68-3 } or a similar stamp of a preceding bank endorser. Do not protest items of $10 or less. WIRE ADVICE of non-payment of *all items of* $500 *or over*, giving the date of our letter, the ENDORSEMENT IMMEDIATELY PRECEDING OURS, and the reason for non-payment. Please detach and return the accompanying coupon as acknowledgment, using "PAID" stamp in space provided.

FEDERAL RESERVE BANK OF RICHMOND.

(Checks listed aggregating in amount 21,041.02)

T 36 **EXHIBIT #8.**

FEDERAL RESERVE BANK OF RICHMOND No. 88942

Your CASH LETTER has been received and collected this day. Dated

Any unpaid items have been returned in a separate letter. Total,

Use "PAID" stamp (including date) in this space to acknowledge receipt.

Oct. 9, 1926

PAID

Farmers & Merchants National Bank
Lake City, S. C.

Farmers & Merchants Nat'l Bank,
Lake City,
S. C.

67-239 Oct 8 1926

21,041.02 Oct 12 1926

BK-9 FEDERAL RESERVE BANK OF RICHMOND

NAME FARMERS & MERCHANTS NAT'L BANK

ADDRESS LAKE CITY, S. C.

OLD BALANCE		DEBITS			
14	28,793.03				
15	28,834.02	Sep 15	DS	15,362.00—	
15	43,472.02				
16	43,564.97	Sep 16	RM	19,694.16—DS	1,500.00—
16	52,592.26	Sep 16	CY	10,000.00—CY	7,500.00—
17	35,092.26	Sep 17	RM	29,265.81—ER	.01—
17	58,355.11				
18	58,403.18	Sep 18	RM	26,911.42—IN	33.57—
18	55,180.18				
20	55,733.06	Sep 20	RM	31,918.99—DS	3,075.00—
		Sep 20	CL	175.30—	
20	35,563.77				
21	35,646.87	Sep 21	RM	16,500.72—RM	32,698.52—
		Sep 21	DS	2,600.00—	
22	34,103.93	Sep 22	DS	1,200.00—	
22	47,903.93	Sep 22	TR	2,700.00—	
23	45,644.41	Sep 23	RM	31,077.56—DS	100.00—
23	35,029.86	Sep 23	DS	29,149.15—CY	1,000.00—
		Sep 23	CY	2,000.00—	
24	2,880.71	Sep 24	RM	21,464.36—	
25	41,580.85	Sep 25	RM	22,160.96—	
27	54,617.94	Sep 27	RM	21,219.08—	
27	53,398.86				
28	53,564.97	Sep 28	RM	28,513.38—RM	16,538.06—
29	38,574.20				
30	53,589.30	Sep 30	RM	23,634.45—	
30	59,962.62	Sep 30	CY	6,000.00—CY	4,000.00—
		Sep 30	CY	800.00—	
1	49,162.62	Oct 1	RM	20,657.18—	
1	48,505.44				
2	48,523.40	Oct 2	RM	14,202.32—	
4	49,390.83	Oct 4	RM	11,203.30—	
4	58,187.53	Oct 4	TR	1,900.00—	
5	56,799.06	Oct 5	RM	17,530.10—RM	33,368.95—
5	35,900.01				
6	36,899.31	Oct 6	RT	12.15—	
6	36,887.16				
7	36,960.50	Oct 7	RM	42,401.94—	
7	34,696.33	Oct 7	TR	2,500.00—	
8	32,196.33	Oct 8	RM	33,165.53—CL	200.00—
		Oct 8	CL	200.00—	
38	18,781.16				
9	26,781.16	Oct 9	RM	21,848.99—	
9	21,932.17				
11	22,085.52	Oct 11	RM	14,934.12—ER	.04—
11	12,151.36				
11	12,235.06	Oct 11	RT	5,000.00—	
12	7,235.06	Oct 12	RM	21,041.02—RM	26,230.39—
12	13,069.82—				
13	7,971.20				
14	8,056.97	Oct 14	ER	83.70—ER	736.13—
		Oct 14	ER	85.77—	
14	7,186.66				
15	7,187.26				
21	7,187.86	Oct 21	TR	7,187.86—	

EXHIBIT #9.

BACK

Year 1926

			CREDITS			NEW BALANCE		
Sep	14	RT	40.99			Sep	14	28,834.02*
Sep	15	RM	20,000.00	RM	10,000.00	Sep	15	43,472.02*
Sep	15	RT	92.95			Sep	15	43,564.97*
Sep	16	RM	30,000.00	RT	221.45	Sep	16	52,592.26*
Sep	16					Sep	16	35,092.26*
Sep	17	TR	15,000.00	RM	37,528.67	Sep	17	58,355.11*
Sep	17	RT	48.07			Sep	17	58,403.18*
Sep	18	RM	23,721.99			Sep	18	55,180.18*
Sep	18	RT	552.88			Sep	18	55,733.06*
Sep	20	RM	15,000.00			Sep	20	35,563.77*
Sep	20	RT	83.10			Sep	20	35,646.87*
Sep	21	RM	256.30	RM	30,000.00			
Sep	21	RM	20,000.00			Sep	21	34,103.93*
Sep	22	RM	15,000.00			Sep	22	47,903.93*
Sep	22	RT	440.48			Sep	22	45,644.41*
Sep	23	RT	563.01	RM	20,000.00	Sep	23	35,029.86*
Sep	23					Sep	23	2,880.71*
Sep	24	RT	164.50	RM	30,000.00			
Sep	24	RM	30,000.00			Sep	24	41,580.85*
Sep	25	RM	198.05	RM	15,000.00			
Sep	25	RM	20,000.00			Sep	25	54,617.94*
Sep	27	RM	20,000.00			Sep	27	53,398.86*
Sep	27	RT	166.11			Sep	27	53,564.97*
Sep	28	RT	60.67	RM	30,000.00	Sep	28	38,574.20*
Sep	29	RT	15.10	RM	15,000.00	Sep	29	53,589.30*
Sep	30	RT	7.77	RM	30,000.00	Sep	30	59,962.62*
Sep	30					Sep	30	49,162.62*
Oct	1	RM	20,000.00			Oct	1	48,505.44*
Oct	1	RT	17.96			Oct	1	48,523.40*
Oct	2	RT	69.75	RM	15,000.00	Oct	2	49,390.83*
Oct	4	RM	20,000.00			Oct	4	58,187.53*
Oct	4	RT	511.53			Oct	4	56,799.06*
Oct	5	RM	30,000.00			Oct	5	35,900.01*
Oct	5	RT	999.30			Oct	5	36,899.31*
Oct	6					Oct	6	36,887.16*
Oct	6	RT	73.34			Oct	6	36,960.50*
Oct	7	RT	137.77	RM	20,000.00			
Oct	7	TR	20,000.00			Oct	7	34,696.33*
Oct	7					Oct	7	32,196.33*
Oct	8	RT	5,150.36	RM	15,000.00	Oct	8	18,781.16*
Oct	38	TR	8,000.00			Oct	38	26,781.16*
Oct	9	TR	10,000.00	RM	7,000.00	Oc	9	21,932.17*
Oct	9	RT	153.35			Oct	9	22,085.52*
Oct	11	RM	5,000.00			Oct	11	12,151.36*
Oct	11	RT	83.70			Oct	11	12,235.06*
Oct	11					Oct	11	7,235.06*
Oct	12	RT	26,230.39	RT	736.14	Oct	12	13,069.82OB
Oct	12	RT	21,041.02			Oct	12	7,971.20*
Oct	13	RT	85.77			Oct	13	8,056.97*
Oct	14	RT	15.00	RT	10.00			
Oct	14	RT	8.50	RT	1.80	Oct	14	7,186.66*
Oct	14	EX	.60			Oct	14	7,187.26*
Oct	15	EX	.60			Oct	15	7,187.86*
Oct	21					Oct	21	.00*

PROCEEDINGS IN THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE FOURTH CIRCUIT.

No. 2750.

Federal Reserve Bank of Richmond, Appellant,

versus

Thos. A. Early, Receiver of the Farmers and Merchants National Bank of Lake City, Appellee.

Appeal from the District Court of the United States for the Eastern District of South Carolina, at Charleston.

May 14, 1928, the transcript of record is filed and the cause docketed.

Same day, the original notice of appeal, petition for appeal, order allowing appeal, appeal bond, and citation are certified up under Sec. 7 of Rule 14.

Same day the appearance of M. G. Wallace is entered for the appellant.

May 17, 1928, the appearance of R. E. Whiting is entered for the appellee.

May 28, 1928, twenty-five copies of the printed record are filed.

ORDER GRANTING LEAVE TO GEORGE P. BARSE AND F. G. AWALT TO FILE BRIEF ON BEHALF OF COMPTROLLER OF THE CURRENCY, AS AMICUS CURIAE.

Filed November 9, 1928.

(Style of Court and Title Omitted.)

UPON THE APPLICATION of George P. Barse, and for good cause shown,

LEAVE is hereby granted George P. Barse and F. G. Awalt to file a brief on behalf of the Comptroller of the Currency of the United States, as *amicus curiae* in the above case.

JOHN J. PARKER,
U. S. Circuit Judge Presiding.

November 9, 1928.

ARGUMENT OF CAUSE.

November 9, 1928, (October term, 1928), cause came on to be heard before Parker and Northcott, Circuit Judges, and Coleman, District Judge, and is argued by counsel and submitted.

OPINION.

Filed January 14, 1929.

UNITED STATES CIRCUIT COURT OF APPEALS

Fourth Circuit.

No. 2750.

Federal Reserve Bank of Richmond, Appellant,

versus

Thos. A. Early, Receiver of the Farmers and Merchants National Bank of Lake City, Appellee.

Appeal from the District Court of the United States for the Eastern District of South Carolina, at Charleston.

(Argued November 9, 1928. Decided January 14, 1929.)

Before PARKER and NORTHCOTT, Circuit Judges, and COLEMAN, District Judge.

MAXWELL G. WALLACE for Appellant, and R. E. WHITING for Appellee, and GEORGE P. BARSE, Attorney for Comptroller of the Currency of the United States (F. G. AWALT on brief) as *amicus curiae*.

PARKER, Circuit Judge:

This action was instituted in the court below by the Receiver of the Farmers and Merchants Bank of Lake City, South Carolina, to recover of the Federal Reserve Bank of Richmond, Virginia, a reserve deposit balance of $22,088.48 alleged to be owing by the Reserve Bank to the Merchants and Farmers Bank at the time of the failure of the latter, and also to recover the sum of $4,115.15, being the surrender value with accrued dividends of 78 shares of stock in the Reserve Bank owned by the Farmers and Merchants Bank at the time of its failure. The Reserve Bank admitted the deposit balance and the liability on the stock, but pleaded the right to apply the deposit balance on checks drawn on the Farmers and Merchants Bank which it had received for collection and under its rules had forwarded to the latter bank for the purpose of effecting collection. As to the amount due on the stock, it pleaded the right to apply this as a set off against the balance remaining due on the checks after applying the deposit balance. The facts were stipulated and a jury trial was duly waived. The trial judge held as a matter of law that the Reserve Bank was not entitled to apply the deposit balance or set off the stock liability as claimed, and gave judgment in favor of the Receiver for the full amount demanded. The Reserve Bank has appealed.

The checks which the Reserve Bank claims the right

to charge against the account of the failed bank or upon which it seeks to apply the balance of that account, are checks which were sent to it for collection. It was handling them as collection agent under its clearance and collection system, which it had established under the authority to act as a clearing house for its member banks. See Sec. 16 of Federal Reserve Act. This collection system, which was agreed to by the forwarding banks as well as by the banks upon which the checks were drawn, was characterized, so far as the checks here are concerned, by the following provisions: (1) The Reserve Bank was acting only as agent of the forwarding banks and assumed no liability except for its own negligence; (2) it was authorized to send the checks direct to the drawee bank for collection; (3) the amount of any check for which payment "in actually and finally collected funds" was not received by the Reserve Bank was authorized to be charged back to the forwarding bank, regardless of whether or not the check itself could be returned; and (4) the checks, unless promptly returned by the drawee bank, were to be charged to its account with the Reserve Bank at the expiration of a designated transit time, in this case three days, but the latter bank reserved the right to so charge them at any time when in any particular case it was deemed necessary to do so. This last provision, because of its importance to the questions here involved, we give in the exact language of the circular sent out by the Reserve Bank to its member banks, as follows:

"* * * the amount of any cash letter to a member bank is chargeable against available funds in the reserve account of such member at the expiration of such transit time, which date will be shown on each cash letter. The right is reserved, however, to charge a cash letter to the reserve account of a member bank at any time when in any particular case we deem it necessary to do so."

The balance of the insolvent bank which the Reserve Bank seeks to apply on the checks in controversy is a deposit balance in an account maintained in accordance with Section 19 of the Federal Reserve Act (12 U. S. C. A. 461-464). It was subject to be checked against or withdrawn by the member bank for the pur-

pose of meeting existing liabilities but under the regulations and subject to the penalties prescribed by the Federal Reserve Board, 12 U. S. C. A. 464. These regulations, however, fixed the reserve requirements and prescribed penalties for deficiencies in the reserve. Regulation D, Series of 1924. The stock liability, against which the Reserve Bank seeks to set off the balance due on the checks in controversy, arises out of the ownership of 78 shares of its stock by the insolvent bank. The law provides that upon the insolvency of a member bank such stock shall be cancelled and that cash paid thereon with interest from date of last dividend shall be first applied to all debts of the insolvent bank to the Reserve Bank, and the balance, if any, be paid to the receiver of the insolvent bank. 12 U. S. C. A. 288.

The case arose in the following manner: On Oct. 7, 1926, the Reserve Bank forwarded for collection to the insolvent bank checks drawn against the latter amounting to $14,900.62. On October 8th it forwarded checks amounting to $20,170.71. The insolvent bank received the first lot of checks on October 8th and the second on October 9th. It immediately acknowledged receipt of them in each case; and with the exception of a few small checks, which were dishonored and returned, it marked them paid and charged them on its books to the accounts of the various drawers. The bank closed its doors on October 9th, and a receiver was appointed for its affairs. At that time its reserve balance with the Reserve Bank was $22,088.48. The Reserve Bank did not attempt to charge any of the checks to the account of the failed bank until after notice had been received of its failure. On October 11th, however, it did charge the first lot of checks against it and on the following day the second lot. The latter, however, were later credited to the amount of the failed bank and charged against the customers of the Reserve Bank from whom they had been received for collection, although the checks themselves were not, of course, returned. The Reserve Bank contends that the first lot of checks should be paid in full from the balance in the account of the insolvent bank and that the balance remaining in its account should be applied *pro rata* on the second lot.

Upon these facts two questions arise: (1) whether the deposit balance in favor of the insolvent bank should be applied on the checks in question as contended by the Reserve Bank, and (2) whether the Reserve Bank can set off the balance due on the checks against its stock liability. We shall consider these separately, as they are governed by entirely different principles.

The first question, we think, should be answered in the affirmative. The checks were forwarded by the Reserve Bank to the insolvent bank under an agreement that they should be charged against its account at the expiration of three days, unless returned immediately. They were so sent because the owners for whom the Reserve Bank was acting as agent had consented to the arrangement. As a substitute for the right to have them presented through another bank and collected in cash, the owners had agreed that they be sent direct to the drawee under the agreement that if not promptly returned they be charged against the drawee's reserve balance. When, therefore, they were accepted by the drawee, the owners had the right to demand that they be charged against the drawee's account and that the balance in that account be applied by the Reserve Bank to their payment. The only question that can arise is when does this right of the owners of the checks become fixed so as to constitute it a charge upon the reserve balance. We think that it becomes so fixed when the drawee bank either unequivocally accepts the checks, as in this case, or by failing to return them promptly becomes chargeable with them under the terms of the agreement. When the checks are accepted by the drawee and charged to the accounts of the various drawers, the drawers and indorsers are released and all rights arising out of the checks themselves are extinguished. See *Federal Reserve Bank* v. *Malloy*, 264 U. S. 160; *Cleve* v. *Craven Chemical* Co. (C. C. A., 4), 18 Fed. (2d) 711, 52 A. L. R. 980. By accepting them, therefore, the drawee not only unequivocally manifests its acquiescence that they be charged to its reserve account, but it also releases the parties to whom the holders could look for payment in event of dishonor. The owners have consented that this be done only upon the agreement that the checks be charged to the reserve account of the drawee with the Reserve Bank. When it is

done and the drawers and indorsers are released, surely the right of the owners to have them so charged becomes fixed without necessity for further action.

And this right, we think, depends not upon the theory that the Reserve Bank is the owner of the checks or that it has the right to set off against the insolvent bank; but upon the fact that the contract of the parties has created an equitable charge upon the reserve account of the drawee bank and that such agreement operates as an equitable assignment of so much thereof as may be necessary to pay the checks when they are unequivocally accepted by the drawee. Under familiar principles of equity, such an equitable charge upon a fund arises in favor of a party when he becomes entitled to have his claim paid from that fund. See 3 *Pomeroy's Equity Jurisprudence* (4th Ed.) Secs. 1234, 1235 and 1280; *Fourth Street Bank* v. *Yardley*, 165 U. S. 634, 644; *Hurley* v. *Atchison, Topeka & Santa Fe Ry.*, 213 U. S. 126; *Walker* v. *Brown*, 165 U. S. 664; *Ketchum* v. *St. Louis*, 101 U. S. 306, 317; *Partin and Orendorff Implement Co.* v. *Moulden* (C. C. A., 5th), 228 Fed. 111, cert. denied 241 U. S. 669; *In re Hollins* (C. C. A., 2nd), 215 Fed. 41, L. R. A. 1915 B 438.

It is objected that the check is not to be charged to the account until the end of the transit time, which in this case is three days, and that in the meantime the account is subject to depletion by withdrawal and it is argued that it cannot be said to be subject to a lien or charge for the payment of the checks until they are actually charged against it. But we think it is the right which accrues to the owners of the checks to have them charged to the reserve account of the drawee when the latter has unequivocally accepted them, and not the mere entry in the books of the bank, which is the determinative factor. It is true that the reserve account of the drawee bank is subject to withdrawals and varies from time to time, and that, between the acceptance of the checks by the drawee and the charge entry by the Reserve Bank, the reserve account may have been depleted, as in this case, until it is less than the amount of the checks. This, however, cannot affect the right of the owners of the checks, which has already accrued, to have

them charged against the reserve account or to have the balance remaining in the account at the time of the charging applied so far as it will go toward their payment. The depletion of the account may affect the value of the right of the owners of the checks; we do not see how it can affect the existence of the right. It is analogous to the right of the holder of a check in those jurisdictions where the giving of a check is held to be an equitable assignment *pro tanto* of the funds on which it is drawn. In such case the withdrawal of the funds before the presentation of the check may defeat the right of the holder, but this does not impair the holder's right in the fund if it is not in fact withdrawn before the insolvency of the drawer. It is said that there can be no lien where the account is absolutely under the control of the drawee. But the account here was not under the control of the drawee. It was under the control of the Reserve Bank, which not only could have refused to honor checks and drafts drawn against it but also had the right at any time to charge against it the cash letters outstanding. Of course, until the checks are charged against the account, the right of the owners is not that of a lien upon the exact deposit balance which exists when they are accepted by the drawee, but the right to a charge against the fluctuating balance, the amount of which is made certain either by the expiration of the three days' transit period or by the earlier charging of the checks under the right reserved. *Id certum est quod certum reddi potest.* Although in this case the transit period had not ended at the time of the closing of the drawee bank, the right of the owners of the checks to have them charged against the reserve balance of the drawee had become fixed and irrevocable, and the failure of the bank fixed the amount of the reserve balance applicable to their payment.

In that the rights of the parties depend upon the transactions which occurred prior to the insolvency and not upon the book entries made in carrying them out, the case is not unlike the case of *McDonald, Receiver,* v. *Chemical National Bank,* 174 U. S. 610. In that case it appeared that it was the custom of the failed Capital National Bank to send to the Chemical Bank checks and other cash items which were credited to the account of

the Capital Bank which was frequently overdrawn. Shortly before a receiver was appointed for the Capital Bank it mailed a number of checks and other cash items to the Chemical Bank which were not received by the latter until after the receiver had taken charge and consequently were not credited prior to insolvency. It was held that notwithstanding this fact the Chemical Bank was entitled to retain the items and credit same on the account of the Capital Bank. The decision was based upon the fact that under the course of dealing between the parties the right of the Chemical Bank to the checks and other items arose when they were deposited in the mails, just as here we think that under the agreement of the parties the right of the owners of the checks to have same charged against the reserve account of the drawee bank arose and became fixed when that bank accepted them.

The Receiver argues that the right to charge the checks against the reserve account of the drawee is but the exercise of a power of attorney which is revoked by insolvency and that the situation of the Reserve Bank, therefore, is that of a bank against which a check is drawn, and which has no authority to pay the check after the insolvency of the drawer. It is argued that the Reserve Bank is in the same situation as a collecting bank which has accepted a check in payment of checks held for collection, where the drawer of the check fails before the check is collected. We do not think, however, that the cases are analogous. Under the Federal rule and under the uniform negotiable instruments act, when a check is accepted in payment, it is not an assignment of funds nor is it chargeable against particular funds. It is a mere order upon the drawee, which is revoked by the insolvency of the drawer. Here, however, we have a contract which provides that if the checks forwarded for collection are accepted by the drawer his liability for them shall be chargeable against and paid out of a particularly designated fund, his reserve account with the Federal Reserve Bank. It is not a question of an order upon a third party which such third party may honor or not as he sees fit (*Bank of The Republic* v. *Millard*, 10 Wall. 152); but of a binding agreement in which the holder of the fund is also the collecting agent. We think it falls clearly within the principle announced

by Mr. Justice White in *Fourth Street Bank* v. *Yardley*, 165 U. S. 634, 644, as follows:

"Whilst an equitable assignment or lien will not arise against a deposit account solely by reason of a check drawn against the same, yet the authorities establish that if in the transaction connected with the delivery of the check it was the understanding and agreement of the parties that an advance about to be made should be a charge on and be satisfied out of a specified fund, a court of equity will lend its aid to carry such agreement into effect as against the drawer of the check, mere volunteers, and parties charged with notice."

It is said that the case of *Equitable Trust Co.* v. *First Nat. Bank of Trinidad*, 48 Sup. Ct. 167, is authority against the position of the Reserve Bank, but we do not think so. In that case the Trinidad bank had drawn a draft on a bank in Italy and had arranged with New York bankers to provide the drawee with funds so that the draft could be honored, sending to the New York bankers funds for that purpose. The New York bankers had an account with the Italian bank, but no funds were designated out of which the draft of the Trinidad bank was to be paid. Upon the bankruptcy of the New York bankers, the Italian bank refused to pay the drafts which bankrupts had guaranteed, and their trustee in bankruptcy collected the balance to their credit in the Italian bank. The Bank of Trinidad claimed priority on this fund on the ground that it was charged with a trust in its favor. Its claim was denied for the reason that no fund was designated from which the draft was to be paid and no fund was assigned for the purpose of taking care of it, the ground of the decision being thus succinctly stated by Mr. Justice Holmes: "What the parties meant to establish and what the respondent got was the assurance of a credit abroad to the extent of its check as in the case of a letter of credit, not an attenuated property right in an account to which no special funds were attached and the particulars of which neither the respondent nor the purchaser of the check could know." In the case at bar, however, the checks were sent to the drawee upon the distinct and definite agreement that they were to be paid out of funds in the reserve account of the drawee by

charging them to that account. In the case cited, the New York bankers failed before the draft of the Bank of Trinidad was presented. In the case at bar the checks were accepted by the failed bank and the right to charge them against the reserve account of the drawee had become fixed before its failure. We see nothing in the Bank of Trinidad case which would justify the holding that under such circumstances the checks were not a charge upon the reserve account of the drawee.

With respect to the deposit balance, therefore, our conclusion is that this is not recoverable by the receiver but should be applied by the Reserve Bank upon the checks forwarded for collection. The same conclusion was reached in *Federal Reserve Bank* v. *First National Bank*, 277 Fed. 300, and in *Keyes, Receiver*, v. *Federal Reserve Bank*, an unreported decision of Judge Page Morris of the District of Minnesota. And see also *Storing* v. *First Nat. Bank* (C. C. A. 8th), 28 Fed. (2d) 587, and *Midland National Bank & Trust Co.* v. *First State Bank of Sioux Falls*, —— Minn. ——(Decided Nov. 30, 1928).

On the second question, we do not think that the Reserve Bank has the right to set off the balance due by the insolvent bank on the checks against its stock liability. The Reserve Bank was not the owner of these checks. It was merely an agent for collection; and although it credited them to the accounts of the forwarding banks, this was upon agreement that they might be charged back if not collected, and the second lot of checks has been charged back. The stock liability is a liability created by statute which provides that it "shall be first applied to all debts of the insolvent member bank to the Federal Reserve Bank, and the balance, if any, shall be paid to the receiver of the insolvent bank." 12 U. S. C. A. 288. It is perfectly clear that the liability of the insolvent member bank for these checks is a liability owing to the owners of the checks in which the Reserve Bank is not interested except as collection agent, and is not "a debt of the insolvent member bank to the Federal Reserve Bank" within the meaning of the statute.

Even in the absence of a statutory direction as to how the liability should be applied, a set off of checks held for collection against such a liability would not be allowed, for the reason that demands to be set off against

each other must be mutual, that is they must be due to and from the same parties and in the same capacity. 14 R. C. L. 656; 24 R. C. L. 858; *Morse on Banks and Banking* (6th Ed.), 334; *Bank of the Metropolis* v. *New England Bank*, 6 Howard 212; *Smith* v. *Bath L. & B. Ass'n*, —— Me. ——, 136 Atl. 284, 50 A. L. R. 526; *Yardley* v. *Clothier*, 51 Fed. 506.

Our conclusion, therefore, is that the District Judge erred as a matter of law in finding for plaintiff with respect to the first cause of action, which relates to the deposit account, but that his finding with respect to the second cause of action, which relates to the stock liability, is correct. The judgment rendered will be set aside, therefore, and a new trial will be awarded on the first cause of action.

Reversed in Part.

JUDGMENT.

Filed and Entered January 19, 1929.

UNITED STATES CIRCUIT COURT OF APPEALS,

FOURTH CIRCUIT.

No. 2750.

Federal Reserve Bank of Richmond, Appellant,

vs.

Thos. A. Early, Receiver of the Farmers and Merchants National Bank of Lake City, Appellee.

Appeal from the District Court of the United States for the Eastern District of South Carolina.

This Cause came on to be heard on the transcript of the record from the District Court of the United States for the Eastern District of South Carolina, and was argued by counsel.

On Consideration Whereof, It is now here ordered and adjudged by this Court that the judgment of the said District Court, in this cause, be, and the same is hereby, set aside; that this case be, and the same is hereby, remanded to the District Court of the United States for the Eastern District of South Carolina, at Charleston, for further proceedings not inconsistent with the opinion of the Court filed herein; and that the costs in this Court be divided equally between the parties.

JOHN J. PARKER,
U. S. Circuit Judge.

January 19, 1929.

ORDER STAYING MANDATE.

Filed January 28, 1929.

(Style of Court and Title Omitted.)

Upon the Application of the Appellee, by R. E. Whiting, Esq., his counsel, and for good cause shown,

It Is Ordered that the mandate of this Court in the above case be, and the same is hereby, stayed pending the application of the Appellee in the Supreme Court of the United States for a writ of certiorari to this Court, unless otherwise ordered by this or the said Supreme Court, and provided said application is filed in the said Supreme Court within 45 days from this date.

JOHN J. PARKER,
U. S. Circuit Judge Presiding.

January 28, 1929.

PETITION OF APPELLEE FOR EXTENSION OF TIME WITHIN WHICH TO PRESENT PETITION FOR REHEARING AND FOR A STAY OF THE MANDATE.

Filed February 16, 1929.

(Style of court and Title omitted.)

The petition of Thomas A. Early, as Receiver of the Farmers and Merchants National Bank of Lake City, South Carolina, respectfully shows:

1. That he desires to file a petition for rehearing in the above cause.

2. The issue involved in this cause affects not only the rights of the insolvent bank, but also involves a ruling which will be determinative of the rights of all member banks of the Federal Reserve system; and therefore the office of the Comptroller of the Currency is especially interested in the pending cause.

3. The Comptroller of the Currency has requested that a draft of the petition for rehearing be presented to his office before the same is filed, in order that his office may be fully advised of the positions taken in support of such petition for rehearing, and that his viewpoint in this matter may be properly presented to the Court in such petition.

4. It will be necessary, in order to comply with the request of the Comptroller of the Currency, to procure an extension of time for the filing of the petition for rehearing.

Wherefore your petitioner respectfully prays that an order be made staying the mandate of the Court and granting an extension of fifteen days for the purpose of presenting a petition for rehearing herein.

R. E. WHITING,
Attorney for Thomas A. Early, as Receiver of the Farmers and Merchants National Bank of Lake City, South Carolina.

14th February, 1929.

ORDER EXTENDING TIME WITHIN WHICH APPELLEE MAY PRESENT PETITION FOR REHEARING AND STAYING OF MANDATE.

Filed February 16, 1929.

(Style of Court and Title Omitted.)

Upon the Application of the Appellee, by R. E. Whiting, Esq., his counsel, and for good cause shown,

It Is Ordered that the time required by the rules for the filing of a petition for rehearing in the above entitled cause be, and the same is hereby, extended as asked for and the said Appellee is given leave to present a petition for a rehearing herein on or before March 5, 1929.

And It Is Further Ordered that the mandate of this Court in the above entitled cause be, and the same is hereby, stayed pending the petition of the Appellee for a rehearing, provided the petition is presented on or before March 5, 1929.

EDMUND WADDILL, JR.,
Senior Circuit Judge.

February 16th, 1929.

PETITION OF APPELLEE FOR A REHEARING

Presented March 5, 1929.

(Style of Court and Title Omitted.)

The appellee, by his attorney, R. E. Whiting, respectfully petitions that the opinion in this case be reviewed, and a rehearing granted. And, as grounds of this petition, presents: The conclusions of the opinion rest upon premises which appear to this appellee to be clearly faulty and erroneous, and which are not sustained by an analysis of the record and its accompanying exhibits.

I.

In the opinion, at page 10, it is said:

"* * * the checks were sent to the drawee upon the distinct and definite agreement that they were to be paid out of funds in the reserve account of the drawee * * * and the right to charge them against the reserve account of the drawee had become fixed before its failure."

The agreement in this form is not conceded. If held to exist, it must be implied from regulations and other exhibits. These must be read in their entirety. The basis of the agreement under which the checks were deposited for collection, is found in Section IV (3), of Regulation "J":

"For all such checks as are received for deferred credit in accordance with such time schedule, deferred credit, subject to final payment, will be entered upon the books of the Federal Reserve Bank at full face value, but the proceeds will not be counted as reserve nor become available for withdrawal or other use by the sending bank until such time as may be specified in such time schedule, at which time credit will be transferred from the deferred account to the reserve account or clearing account subject to final payment, and will then be counted as reserve and become available for withdrawal or other use by the sending bank."

The significance of the expression, "*subject to final payment*", as used in the above connection, more clearly appears by reference to Section V (6):

"The amount of any check for which payment in actually and finally collected funds is not received shall be charged back to the forwarding bank, regardless of whether or not the check can be returned."

It is also to be noted that subsections (1) to (6), Section V, are designed specifically to prescribe the "terms and conditions" *imposed* upon "each member and non-member clearing bank which *sends* checks *to* any

Federal Reserve Bank for deposit or collection". In determining the effect that should be given these terms and conditions, and, also, the parties intended to be bound thereby, reference should be had to the first provision of the section, upon which the subsections depend. This is of such importance that we shall quote it in full:

"The Federal Reserve Board hereby authorizes the Federal Reserve Banks to handle such checks subject to the following terms and conditions; and each member and non-member clearing bank which *sends* checks *to* any Federal Reserve Bank for deposit or collection shall *by such action* be deemed (a) to authorize the Federal Reserve Banks to handle such checks subject to the following terms and conditions, (b) to warrant its own authority to give the Federal Reserve Banks such authority, and (c) to agree to indemnify any Federal Reserve Bank for any loss resulting from the failure of such sending bank to have such authority."

The right of the Federal Reserve Bank of Richmond to issue the check collection circular, of which a part only is quoted at page 3 of the opinion, is given by Section VI of Regulation "J":

"Each Federal Reserve Bank shall also promulgate rules and regulations not inconsistent with the terms of the law or of this regulation, governing the details of its check clearing and collection operations. Such rules and regulations shall be set forth by the Federal Reserve Banks in their letters of instruction to their member and non-member clearing banks *and shall be binding upon any member or non-member clearing bank which sends any check to such Federal Reserve Bank for collection* or to any other Federal Reserve Bank for the account of such Federal Reserve Bank for collection."

In sending out the check collection circular, an acknowledgment of receipt was required, reading as follows:

"The undersigned member bank hereby acknowledges receipt of Circular No. 143 of the Federal Re-

serve Bank of Richmond, regarding the 'Collection of Checks', effective July 1, 1926, setting forth the terms and conditions upon which cash items as specified in the circular will be received for collection *from* the undersigned member bank *by* the Federal Reserve Bank of Richmond or by another Federal Reserve Bank for its account, which circular supersedes Circular No. 131 of June 15, 1923."

The receipt in the above form was signed by the Lake City Bank on July 9, 1926. (See Exhibit 4.)

In sending the Lake City Bank the collection items in question, form letters of advice and acknowledgment were also used. We quote from the exhibits which were submitted to the Court in connection with the printed record the proposed terms of collection contained in the cash letter of October 7th, and the acknowledgement and acceptance of the checks under such proposed terms in letter of the Lake City Bank of the 8th, as follows:

(Exhibit #5.)

"No. 88443.

Dispatched Oct. 7, 1926.

Chargeable against available balance in RESERVE ACCOUNT.

Oct. 11, 1926.

We enclose for collection the checks listed below."
* * *

(Exhibit #6.)

"No. 88443.

"Your CASH LETTER has been received and collected this day. * * *

Oct. 7th, 1926.

$14,994.12.

Oct. 11, 1926."

(Stamped "PAID" Oct. 8th, 1926.)

(Exhibits 7 and 8 similarly show the dispatch and acknowledgment of the cash letter of October 8th, chargeable October 12th, containing checks amounting to $21,041.02; the stamp of the Lake City Bank showing acceptance of the cash letter and collection of the items Oct. 9th, 1926.)

As stated in the opinion, the bank, on acknowledging receipt of the checks, "marked them paid, and charged them to the accounts of the various drawers". But this method of collection amounted to a shifting of credits only. It did not furnish funds for remittance. The bank had to provide the funds. Of the three days agreed transit time, two days remained to the Lake City Bank to provide *available* funds at Richmond to meet payment of the items. During this two days period there was no trust relationship in the proceeds of the checks, because, as stated, no moneys were collected, and only a shifting of credits from the accounts of the drawers of the checks to a memorandum account, pending final remittance, occurred. Nor was there a lien on any funds in the bank's reserve account, which reserve account *continued* to be usable for *any* and *all* purposes.

It is the contention of the Receiver that the right of the owners of the checks to have the charge made "against available balances in the reserve account" did not arise until *after* the expiration of the agreed transit time, which was after the Lake City Bank had closed, and *after* the rights of the depositors and other creditors to a ratable distribution of the assets of the bank had become fixed by operation of law.

There is, however, as already indicated, the position taken by the Court that the terms of the check collection circular, as quoted at page 3 of the opinion, created a vested right in the owners of the items (i. e., the depositing banks which sent the items to the reserve bank) to have the amounts of said items charged against the reserve account of the collecting bank, and that such right, inasmuch as it vested as soon as collection was made, was not affected by the subsequent suspension of the bank.

Conceding, for argument, that the circular, dealing with the duties of banks to which cash items are sent, should be thereby deemed to impose terms and conditions

governing the acceptance of cash items by such banks, it should, nevertheless, be kept in mind that the collecting bank is given, by the very provisions of such circular, the right to keep its reserve account intact and make remittance by other means.

The substance of the requirement is merely that available funds be provided at Richmond to make payment for the collected items within the three days period; and, to all practical intents and purposes, the collecting bank could comply with the requirement by providing the funds in such manner as might be convenient to itself.

In order to apprehend this provision in its entirety we will quote it in full:

"OUR CASH LETTERS TO MEMBER BANKS.

"Checks received by us drawn on our member banks will be forwarded in cash letters direct to such banks and each member bank will be required *either* to remit therefor in immediately available funds *or* to provide funds available to us to meet such cash letters *within the agreed transit time* to and from the member bank. Therefore, the amount of any cash letter to a member bank is *chargeable* against *available* funds in the reserve account of such member *at the expiration of such transit time*, which date will be shown on each cash letter. The right is reserved, however, to charge a cash letter to the reserve account of a member bank at any time when in any particular case we deem it necessary to do so."

It will be noted that the amount of the collected items is *not immediately* chargeable to the reserve account, as the Court in its opinions seems to assume, but, on the contrary, it does not become chargeable until the *expiration* of the transit and during and within that transit time the collecting bank has its option of either remitting funds and thereby reserving its reserve account intact so far as said items are concerned, or of awaiting the *expiration* of the transit time and thereby permitting the authority to charge the reserve account to become effective. Clearly the right to charge the reserve account is intended to come into existence only

when the collecting bank has failed, during the transit period, to remit funds, and has, by such inaction, permitted the right to charge to become effective. Such right to charge the reserve account is an alternative authority given by the collecting bank to the Reserve Bank, to become effective in the event the collecting bank has not, at the expiration of the transit time, already made remittance.

It is true the Reserve Bank reserved in its check collection circular the right to charge a cash letter at any time against the account of a member bank, but it is a fact, shown by the record and not questioned, that the Reserve Bank did not see fit to exercise its right until after the suspension of the collecting bank, and, therefore, in accordance with the principles recognized by the Court, the authority to charge is revoked before it is exercised. As a further fact, the right reserved cannot be regarded as having been exercised at all because the charge against the reserve account was made, in the case of each cash letter, *after* the expiration of the conventional transit time.

II.

If the foregoing reasoning on our part is sound, it would seem to dispose of the additional position taken by the Court that there arose, immediately upon collection, not only a vested right in the depositing bank to have such collections charged against the reserve balance, but also that such vested right constituted an equitable lien upon the account. If it be established that no such vested right of charge against the reserve account existed, it necessarily follows that no such lien existed.

In further support of its position that the owners of the items forwarding them to the Reserve Bank had a vested right to have the amount of the checks considered as an equitable charge against the reserve account the moment the items were collected, the Court commented that when the items were collected they were thereby cancelled and the drawers and endorsers were released, and that such forwarding owners

"consented that this be done only upon the agreement that the checks be charged to the reserve account of

the drawee with the Reserve Bank. When it is done and the drawers and endorsers are released, surely the right of the owners to have them so charged becomes fixed without necessity for further action."

This implication cannot, we think, be drawn from the premise of Circular No. 143. The circular explicitly provides that the forwarding banks are to be bound by the various provisons of the circular and by Regulation "J" of the Federal Reserve Board, and portions of said Regulation "J" are then quoted in said circular. Regulation "J", as there quoted, provides that:

(a) The Reserve Bank may either present the checks for payment or send them direct to the bank on which drawn for collection, or may send them to an agent for collection;

(b) The Reserve Bank may accept either cash or bank drafts in payment of or in remittance for said items;

(c) The Reserve Bank will ordinarily forward the items direct to member banks, and that

"such banks will be required to remit or pay therefor at par in cash or bank draft acceptable to the collecting Federal Reserve Bank, or at the option of such Federal Reserve Bank to authorize such Federal Reserve Bank to charge their reserve accounts or clearing accounts."

The banks sending the checks to the Reserve Bank for collection are thus charged with knowledge of the fact that under Regulation "J" the Reserve Bank may collect *either* by cash or bank drafts *or* by charging the amount of the collection to the reserve account of the collecting bank; and they are further charged with notice of the provisions in the circular to the effect that the collecting bank has, "*within the agreed transit time*", the right *either* to remit, "*or* to *provide* funds available to us (the Reserve Bank) to meet such cash letters". Hence, it follows, clearly, that there is no basis for the position assumed by the Court that the owners of the

items, in forwarding them to the Reserve Bank, relied upon any lien upon the reserve account or any vested right to charge against said reserve account when the items should be collected; but, on the contrary, they were charged with notice of the fact that the collecting bank had the right to forward funds by way of remittance and to preserve its account intact, and that the right to charge did not become effective except as "against *available* funds in the reserve account of such members *at the expiration of such transit time*".

Also to be considered as having a vital bearing in this connection are the facts and circumstances:

(a) The duty as declared in Circular No. 143 to provide available funds in the reserve account is without security for its performance.

(b) There is no requirement that balances be carried for the purpose of meeting items in transit.

(c) Neither the amount of balances usually carried, nor the probable extent of withdrawals, nor the particulars of the balances at any given time, are known to the owners of items when they use the Federal Reserve Bank system for the purpose of collections.

(The entries in the reserve account of the Lake City Bank between September 15, 1926, and the closing date (Exhibit No. 9) are interesting and instructive in this connection. Attention is directed particularly to the condition of balances, withdrawals and deposits, shown on the books, between the dates of September 22nd and September 25th. The owners of checks contained in the cash letters sent from Richmond to the Lake City Bank on September 21st and 22nd, would have found on the 23rd only $2,880 as the amount of *available* funds in the reserve account. *Also, to the entries of October 8th and 9th*: The reserve balance of October 8th, when the cash letter of the 7th was accepted by the Lake City Bank, was $32,196. Charges greatly exceeding this balance (amounting in the aggregate to over $55,000) were made on the 8th and 9th against the reserve account. Necessarily, therefore, the balance of $22,085, appearing in the reserve account of the 11th, after the bank had

closed, was created by deposits made subsequent to the handling of the checks contained in the cash letter of the 7th.)

(d) Checks drawn on non-member and non-affiliated banks, which have neither reserve nor clearing accounts, are received for collection by the Reserve Banks and are similarly subject to handling by sending direct to the drawee bank. Consent that the checks be surrendered, and the drawers released, and the right arising out of the checks extinguished, cannot, in such cases, be attributed to the faith of reserve balances, but is based on nothing more than the mere contractual duty to remit by cash or bank draft—subject to the hazard of possible insolvency of the drawee bank before the remittance is completed by final collection.

(e) The Federal Reserve Act, while setting out clearly and specifically the provisions governing reserve balances and enumerating in detail the duties and powers of the Federal Reserve Board and the functions to be exercised by the Federal Reserve Bank, does not, however, by any specific provision, confer any power upon either the Federal Reserve Board or the ReserveBanks to appropriate the reserve balances carried by member banks, or to create an equitable charge against such balances, in the aid of the clearing house functions of the system.

The Act, therefore, cannot be deemed to impose any agreement upon the member bank to give a fixed and irrevocable right to charge its balances in aid of clearances; nor would it seem that the mere acceptance of the items could be regarded as constituting such agreement, because under the express provision of the Federal Reserve Act, as construed by the Supreme Court, the banks to which checks are sent for collection are compelled to remit at par, and the acceptance of such items could not be refused without appearing to violate the statute.

Again requesting the Court to keep in mind the unquestionable fact that the reserve account of the Lake City Bank could be used for any and all purposes of the bank during the two days period intervening be-

tween the acceptance of the checks and the expiration of the transit period, and that the amount of *available* balances at the *expiration* of the transit period is necessarily dependent on the extent of withdrawals and deposits occurring after the acceptance of the checks, we submit that the well established principles governing equitable liens clearly show that the banks owning the checks are not entitled to an equitable charge upon the funds carried in the reserve account.

In the *Interborough Consolidated Corporation* case, 238 Fed. 234, 32 A. L. R. 932, 947 (*Certiorari* denied 262 U. S. 752, 67 L. Ed. 1215), it is said:

"A particular fund is not charged unless it is bound for an obligation imposed."

The application of the same principle is found in *Woodhouse* v. *Crandall,* 197 Ill. 104, 58 L. R. A. 385, where it is said:

"This deposit was for a specific purpose, for the benefit and security of a third person, and it created a trust relation in his favor. The banking firm assumed the position of a trustee and the money deposited constituted a trust fund *which the bank was bound to keep intact for the purpose of the trust."*

So also in the *Butterworth-Judson* case, 69 Law Ed. 672, an equitable charge was held to be established by the deposit of money "in *special* accounts in banks *separate* from its other funds", to be drawn only for specific purposes. This equitable lien was said to be created by the agreements making the balances in the special accounts security, in that:

"The purpose and effect of the special accounts was * * * *to limit the use of the fund to the purposes specified,* and so to make it available as security. * * *"

Similarly, in the *Bank of Trinidad* case (cited and discussed at pages 9-10 this opinion), the sole question at issue was whether a *special* account had been estab-

lished and the use of the funds irrevocably *limited* to the purposes specified. Mr. Justice Stone considered that this had been done "by *specifically* designating and *setting apart*" enough of the bankrupt's account to meet the payment. The majority opinion written by Mr. Justice Holmes differed with this conclusion; holding that the transactions did not constitute the appropriation of a fund for a specific use, and, consequently, that they did not operate to establish—

"an attenuated property right in an account to which no *special* funds were attached, and the particulars of which neither the respondent nor the purchaser of the check could know."

Concerning the agreement of the bankrupt, "on the faith of which the petitioner sold its draft", Mr. Justice Stone said:

"It provided specifically the method of a payment; that the bankrupt should 'promptly', on notice of the draft, 'provide the drawee with funds sufficient for the payment of the draft abroad, by a transfer of credit or otherwise'."

The contention that the method thus provided for payment had given the holder of the draft equitable rights in the bankrupts' deposit is met and answered in the opinion of Mr. Justice Holmes by the succinct statement:

"Again, the terms offered by the bankrupts to their correspondents seem to us to promise the appropriation of a specified fund to the draft as little as they promise to apply the money received by them to that end. They are to provide the drawee banks with sufficient funds for the payment of the drafts by transfer of credit from our balance 'or otherwise'. They are to provide, that is, as convenient to themselves, for payment by the drawee banks, not to give them an earmarked *corpus* to be handed over."

May we not properly follow in this case the same

trend of thought voiced by Mr. Justice Holmes in the comments above quoted?

The terms upon which the cash items were sent to the Lake City Bank seem to promise the appropriation of a specified fund as little as the bank promised to apply the proceeds of the collection to that end.

The sole requirement of the Lake City Bank was to provide the Reserve Bank with funds sufficient for the payment of the checks by transfer of credit from available funds in the reserve accounts, or otherwise. It was to provide these funds *in such manner as might be convenient to itself* within the three days transit period —not to furnish upon the acceptance of the checks either "an earmarked *corpus* to be handed over", or "an attenuated property right in an account to which no special funds were attached".

III.

After the appeal had been argued and taken under advisement, the attention of the Court was called by appellant's attorney (in manner as provided by the rules of the Court) to the Storing and Midland National Bank cases, to which reference appears at page 11 of the opinion. The Court having deemed it proper to cite these cases as supporting authorities, their influence upon the opinion, as a factor of decision, may be fairly assumed. In this we think the Court failed to take into consideration the real character of the decisions and points of difference appearing therein, which, on a closer analysis, will be obvious.

Thus, in this opinion at page 11, it is pointed out that the Reserve Bank was not the owner of the checks but was merely the agent for collection, and that—

"It is perfectly clear that the liability of the insolvent member bank for these checks is a liability owing to the owners of the check in which the Reserve Bank is not interested except as collection agent, and is not 'a debt of the insolvent member bank to the Federal Reserve Bank.'."

In *Storing* v. *National Bank*, 28 Fed. (2nd) 587, it seems, however, to have been assumed (without any par-

ticular consideration of the point) that the items in question were owned by the forwarding bank in its own right, and that, as soon as the collections were made, the collecting bank became the debtor of the bank transmitting the items for collection. Upon the basis of this assumption the right of offset was held to exist. The premise governs the conclusion; and manifestly the conclusion has no application in the present case where the premise is the exact opposite.

In the Midland National Bank case (Minn.), the position was taken that the forwarding bank "had the legal title, so to speak, to the dishonored drafts". The same criticism as that made of the Storing case applies. The decision in the Midland case seems also to be substantially influenced, if not wholly controlled, by the viewpoint that the claim involved only the amount by which the assets of the insolvent bank "were enhanced through the collections made immediately prior to its suspension". This also presents an obvious point of difference from the present case, where the checks were all drawn on the insolvent bank and were collected by charging them to the accounts of depositors of that bank, resulting in a shifting of credits rather than in an augmentation of assets (see 13 Fed. 330).

See also discussion in original brief for appellee, at pages 29-33, analyzing the positions taken in *Federal Reserve Bank* v. *First Nat. Bank*, 277 Fed. 300, and *Kayes, Receiver*, v. *Federal Reserve Bank* (unreported decision of Judge Morris).

For the foregoing reasons, and particularly in view of the importance of this decision in its general effect upon banking conditions under the Federal reserve system, we respectfully submit that the Court should grant a rehearing in this cause, in order that the matters presented in this petition may be fully and thoroughly considered.

R. E. WHITING,
Attorney for Petitioner.

As counsel for the petitioner, Thos. A. Early, Receiver of the Farmers and Merchants National Bank of Lake City, South Ctrolina, I hereby certify that, in my

judgment, the foregoing petition for rehearing is well founded, and that it is not interposed for delay.

R. E. WHITING.

Columbia, S. C., March 4th, 1929.

ORDER DENYING REHEARING.

Filed and Entered April 9, 1929.

UNITED STATES CIRCUIT COURT OF APPEALS,

FOURTH CIRCUIT.

No. 2750.

Federal Reserve Bank of Richmond, Appellant,

vs.

Thos. A. Early, Receiver of the Farmers and Merchants National Bank of Lake City, Appellee.

Appeal from the District Court of the United States for the Eastern District of South Carolina, at Charleston. At Law.

This Court having at its January term, 1929, rendered its decision reversing in part the judgment of the said District Court appealed from in this case, and the appellee having on March 5, 1929, presented to the Court a petition for a rehearing of the said case, and the same having been carefully considered.

It Is Now Here Ordered by This Court that the rehearing asked for, be, and the same is hereby, denied

at the cost of the appellee. Let mandate issue after the expiration of five days from this date.

JOHN J. PARKER,
U. S. Circuit Judge.

April 9, 1929.

On another day, to-wit, May 6, 1929, the mandate of this Court in this case is issued and transmitted to the United States District Court at Charleston, South Carolina, in due form.

Same day, the original notice of appeal, petition for appeal, order allowing appeal, and bond are returned to the Clerk of the District Court at Charleston, South Carolina.

CLERK'S CERTIFICATE.

UNITED STATES OF AMERICA,
Fourth Circuit, ss:

I, Claude M. Dean, Clerk of the United States Circuit Court of Appeals for the Fourth Circuit, do certify that the foregoing is a true copy of the record and proceedings in the therein entitled cause, made up in accordance with the request of counsel, as the same remains among the records and files of the said Circuit Court of Appeals.

IN TESTIMONY WHEREOF, I hereto set my hand and affix the seal of the said United States Circuit Court of Appeals for the Fourth Circuit, at Asheville, North Carolina, this 3rd day of July, A. D., 1929.

CLAUDE M. DEAN,
Clerk, U. S. Circuit Court of Appeals, Fourth Circuit.

(Seal of Court)

SUPREME COURT OF THE UNITED STATES

ORDER ALLOWING CERTIORARI—Filed October 21, 1929

The petition herein for a writ of certiorari to the United States Circuit Court of Appeals for the Fourth Circuit is granted. And it is further ordered that the duly certified copy of the transcript of the proceedings below which accompanied the petition shall be treated as though filed in response to such writ.

FILE COPY

FILED
FEB 25 1930
CHARLES ELMORE CROPLEY
CLERK

SUPREME COURT OF THE UNITED STATES.

OCTOBER TERM, 1929.

No. 226

THOMAS A. EARLY, RECEIVER OF THE FARMERS & MERCHANTS NATIONAL BANK OF LAKE CITY, PETITIONER,

vs.

FEDERAL RESERVE BANK OF RICHMOND, RESPONDENT.

STIPULATION SUPPLYING KEY TO CERTAIN ABBREVIATIONS APPEARING IN TRANSCRIPT OF RECORD.

R. E. WHITING,
Counsel for Petitioner.
M. G. WALLACE,
Counsel for Respondent.

SUPREME COURT OF THE UNITED STATES.

OCTOBER TERM, 1929.

No. 226

THOMAS A. EARLY, Receiver of the Farmers & Merchants National Bank of Lake City, Petitioner,

vs.

FEDERAL RESERVE BANK OF RICHMOND, Respondent.

STIPULATION SUPPLYING KEY TO CERTAIN ABBREVIATIONS APPEARING IN TRANSCRIPT OF RECORD.

Come now, counsel for petitioner, and counsel for respondent, in the above entitled cause, and, by leave of Court first had and obtained, stipulate that the following constitutes a key to the abbreviations of bank-

ing terms appearing on pages 64 and 65 of the transcript of record:

Abbreviation.	Meaning.	
	Debit Side.	Credit Side.
DS	Discounted notes charged to bank at maturity.	Notes discounted for bank.
RM	Checks sent to bank in cash letters.	Checks deposited with Reserve Bank by member bank.
CY	Currency sent to bank.	Currency received from bank.
CL	Note or draft collected by member bank, charged on advice of collection.	Maturing note or draft collected for member bank.
TR	Transfer of credit from bank on its order.	Transfer of credit to bank on order of transferer.
RT	Checks returned dishonored or unpaid.	Checks returned dishonored or unpaid.
ER	Error or reversal of previous entry.	Error or reversal of previous entry.
IN	Interest.	Interest.
EX	Exchange.	Exchange.

R. E. WHITING,
Counsel for Petitioner.
M. G. WALLACE,
Counsel for Respondent.

FILE COPY

FILED
JUL 8 1929
CHARLES ELMORE CROPLEY
CLERK

SUPREME COURT OF THE UNITED STATES.

OCTOBER TERM, 1929.

No. 226

THOMAS A. EARLY, RECEIVER OF THE FARMERS & MERCHANTS NATIONAL BANK OF LAKE CITY, PETITIONER,

v.

FEDERAL RESERVE BANK OF RICHMOND, RESPONDENT.

PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE FOURTH CIRCUIT AND BRIEF IN SUPPORT THEREOF.

R. E. WHITING,
Counsel for Petitioner,
Columbia, S. C.

(34,357)

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SUPREME COURT OF THE UNITED STATES.

OCTOBER TERM, 1929.

No. 226

THOMAS A. EARLY, RECEIVER FOR THE FARMERS & MERCHANTS NATIONAL BANK OF LAKE CITY, PETITIONER,

v.

FEDERAL RESERVE BANK OF RICHMOND, RESPONDENT.

PETITION FOR WRIT OF CERTIORARI.

MAY IT PLEASE THE COURT:

The petition of Thomas A. Early, as Receiver of the Farmers & Merchants National Bank of Lake City, South Carolina, respectfully shows to this Honorable Court:

A.

Statement of the Matter Involved.

In an action brought at law in the District Court of the United States for the Eastern District of South

In

Carolina, an order of judgment was made, on May 9th, 1928, by District Judge Ernest F. Cochran, in favor of petitioner, as plaintiff, against Federal Reserve Bank of Richmond, Virginia, as defendant, for the recovery of $22,088.48, with interest $1,417.38, aggregating in amount $23,505.86,—this being the amount of a deposit balance claimed by petitioner to be owing by the Reserve Bank to the Farmers & Merchants National Bank of Lake City, South Carolina, at the time of the failure of the latter bank (R. 11).

The Reserve Bank appealed. The finding of the District Court relating to the deposit account was reversed; the judgment set aside; and a new trial awarded; the decision of the Circuit Court being, however, final in effect, and conclusive upon the court below, in respect to the judgment to be entered in the cause. The decision of the Circuit Court sustained the right of the Reserve Bank to apply the deposit balance to the benefit and protection of depositing banks which had used its clearing house system to collect checks drawn on the failed bank (R. 68).

The issue raised by the answer of the Reserve Bank, and decided in its favor by the Circuit Court of Appeals, is stated in the brief of the Reserve Bank on argument before the Circuit Court, as follows:

> *Was the Federal Reserve Bank of Richmond entitled to charge the amount of the checks sent to the Farmers and Merchants National Bank of Lake City and accepted and cancelled by it before its failure against the apparent balance due to the Farmers and Merchants National Bank of Lake City at the time of the failure?*

The position taken by petitioner, as Receiver of the Lake City Bank, acting under instructions of the Comptroller of the Currency, is set out in his reply (R. 10).

1. The checks were received by the Reserve Bank for deferred credit and had not become available for withdrawal or other use by the sending banks at the time of the suspension and closing of the Lake City Bank.

2. In receiving and handling such checks for collection, the Reserve Bank did not become the owner of the paper, but acted only as agent of the banks from which it received the checks.

3. The Reserve Bank was notified of the suspension and closing of the Lake City Bank before the charges were made against the reserve account.

4. After notice of the suspension and closing of the Lake City Bank, no right existed on the part of the Reserve Bank to charge the reserve account of the failed bank with any outstanding collection items.

The case was tried under an agreement waiving jury, on a stipulation of facts (R. 15-23); the material facts being the following: On October 7th, 1926, the Reserve Bank forwarded for collection to the insolvent bank checks drawn against the latter amounting, less checks dishonored and returned, to $14,900.62. On October 8th the Reserve Bank forwarded checks amounting to $20,170.71. The insolvent bank received the first lot of checks on October 8th and the second on October 9th. It immediately acknowledged receipt

of them in each case; the accepted checks being marked paid and charged to the accounts of the various drawers. The bank closed its doors on October 9th, and passed into the hands of the Comptroller of the Currency. At that time its reserve balance with the Reserve Bank was $22,088.42. The Reserve Bank did not attempt to charge any of the checks to the account of the failed bank until after notice had been received of its failure. On October 11th, however, it did charge the first lot of checks against it, and on October 12th the second lot. The latter, however, were later credited to the account of the failed bank and charged against the customers of the Reserve Bank, from whom they had been received for collection, although the checks themselves were not, of course, returned. (Statement contained in opinion of Circuit Court (R. 70) substantially adopted.)

The Reserve Bank was handling the checks as collection agent under its clearing and collection system, which it had established under its authority to act as a clearing house for its member banks (Federal Reserve Act). For convenience of reference, the pertinent statutory provisions and the regulations of the Federal Reserve Board governing "check clearing and collection" are set out in full in Appendix A and Appendix B, following this petition. A check collection circular, or letter of instructions to member banks, was also issued by the Richmond Reserve Bank (R. 47). This was issued under the authorization of section VI of regulation J, series of 1924, as "governing the de-

tails of its check clearing and collection operations," which "shall be binding upon any member or non-member clearing bank which *sends* any checks to such Federal Reserve Bank for collection." The pertinent part of the circular, under the heading "Our Cash Letters to Member Banks," is the following:

> "Checks received by us drawn on our member banks will be forwarded in cash letters direct to such banks and each member bank will be required either to remit therefor in immediately available funds or to provide funds available to us to meet such cash letters within the agreed transit time to and from the member bank. Therefore, the amount of any cash letter to a member bank is chargeable against available funds in the reserve account of such member at the expiration of such transit time, which date will be shown on each cash letter. The right is reserved, however, to charge a cash letter to the reserve account of a member bank at any time when in any particular case we deem it necessary to do so."

The two cash letters, under which the checks were forwarded to the Lake City Bank for collection, show the date of expiration of the agreed transit time on such collection items as follows: (1) "Dispatched October 7, 1926. Chargeable against *available balance* in reserve account, October 11, 1926"; (2) "Dispatched October 8, 1926. Chargeable against *available balance* in reserve account, October 12, 1926" (R. 62, 63). The drawee bank, charging the checks to the account of its own depositors, received no funds from

the collection. It had to provide the funds. It agreed to provide the funds by the date shown in the cash letters. The available funds in the reserve balance at that time would become chargeable if payment had not otherwise been made. The import of this agreement, and the actual practice thereunder, was that the reserve balance should be maintained as a general deposit account until the charge for outstanding checks was actually made against such account. The reserve balance was of constantly fluctuating and uncertain nature, subject to be checked against and withdrawn for the purpose of meeting existing liabilities. (See Appendix A.)

Attention in this connection is called to the ledger sheet, showing the condition of the insolvent bank's account from September 15, 1926, until the closing date of the bank (R. 64-65). The reserve balance of October 8, when the cash letter of October 7th was accepted by the Lake City Bank, was $32,196.00. Charges greatly exceeding this balance (amounting in the aggregate to over $55,000.00) were made on the 8th and 9th against the reserve account. Necessarily, therefore, the balance appearing in the reserve account of the 11th, after the bank had closed,—still lacking $12,982.85 of being enough to meet the two cash letters outstanding,—was created by deposits made subsequent to the drawee bank's acceptance of the checks contained in the cash letter of the 7th.

In the holding of the decision that the deposit balance is not recoverable by the receiver but should be

applied by the reserve bank upon the checks forwarded for collection, the Circuit Court places reliance upon the erroneous and unfounded premise that the use of the "cash letter" method of check collection was based on faith of the reserve balance; falling, in consequence of such erroneous premise, into the fundamental error that the contract of the parties had created an equitable charge upon the reserve account arising upon the acceptance of the checks by the failed bank.

B.

Reasons Relied on for the Allowance of the Writ.

1. An important question of banking law, arising under the Federal Reserve Act, and involving the construction of regulations issued by the Federal Reserve Board under the authority of said Act, is decided by the Circuit Court of Appeals in this case, in a way probably untenable, and probably in conflict with applicable decisions of this Court. The nation-wide field of banking interests that are covered by the Federal reserve clearing and collection system,—all rules and regulations of regional reserve banks being necessarily subsidiary to the regulations of the Federal Reserve Board,—make the present decision of even greater public interest and importance than the case of Equitable Trust Co. *v.* First National Bank of Trinidad, in which, the right to assert an equitable lien being upheld by the Circuit Court of Appeals (2d circuit), a writ of certiorari was granted (273 U. S. 684) and a decision rendered by this Court reversing the decision below (275 U. S. 359).

The position taken by the Circuit Court of Appeals is not consistant with the ruling made in the Bank of Trinidad case, *supra;* nor with the principles of general law governing equitable liens and charges, as determined by the weight of authority, and as recognized and applied by the Federal courts in the cases of Christmas *v.* Gaines, 14 Wall. 69; United States *v.* Butterworth-Judson Corp., 267 U. S. 387, and the Interborough Consolidated Corp. case, 288 F. 334, certiorari denied, 262 U. S. 752).

2. The decision, by sustaining and upholding the appropriation by the reserve bank of the reserve balance of a member bank, after it had closed, has probably allowed a preference to be made in favor of the holders of collection items handled through the Federal reserve clearing house system, contrary to statutory provision (12 U. S. C. A. 91), and conflicting with the Federal decision which, in Scott *v.* Armstrong, 146 U. S. 499, and various other cases cited in 12 U. S. C. A. 91, note 64, have held that no additional rights can be created by either voluntary or involuntary proceedings, after an act of insolvency has been committed.

3. The decision involves an important question of banking law, of Federal nature, which has not been, but should be, settled by this Court. There are twelve regional reserve banks in existence under the Federal Reserve Act (12 U. S. C. A. 222, and note); and having the authority to exercise clearing house functions for their member banks, and nonmember clearing banks, under the provisions of the Federal Reserve

Act, as amended by the Act approved June 21, 1917 (12 U. S. C. A. 248 (*m*)). Each of these regional banks has its own check clearing and collection system under the regulations issued by the Federal Reserve Board (Appendix B). An enormous volume of check collections is done through these channels. The question now in issue has for the first time been decided by one of the Circuit Courts.

In almost every national bank failure, and in a high percentage of State bank failures, similar questions are likely to arise. The amounts of dividends to be paid to many thousands of depositors concerned in such bank failures, as well as the equities of holders of the collection items, are dependent upon the determination of the question. In the public interest it is, therefore, of the highest importance that the question should be settled by this Court.

WHEREFORE your petitioner respectfully prays that a writ of certiorari be issued out of and under the seal of this Honorable Court, directed to the United States Circuit Court of Appeals for the 4th Circuit, commanding that court to certify and to send to this Court for its review and determination, on a day certain to be therein named, a full and complete transcript of the record and all proceedings in the case numbered and entitled on its docket, No. 2,750, Federal Reserve Bank of Richmond, Appellant, *v.* Thos. A. Early, Receiver of the Farmers and Merchants National Bank of Lake City, Appellee, and that the said judgment of the said Circuit Court of Appeals may be reversed

by this Honorable Court, and that your petitioner may have such other and further relief in the premises as to this Honorable Court may seem meet and just; and your petitioner will ever pray.

THOS. A. EARLY, RECEIVER
OF THE FARMERS & MERCHANTS NATIONAL BANK
OF LAKE CITY,

By R. E. WHITING,
Counsel for Petitioner.

APPENDIX A.

Provisions of Federal Reserve Act.

The Federal Reserve Board shall make and promulgate from time to time regulations governing the transfer of funds and charges therefor among Federal reserve banks and their branches, and may at its discretion exercise the functions of a clearing house for such Federal reserve banks to exercise such functions, and may also require each such bank to exercise the functions of a clearing house for its member banks (Section 16 of the Federal Reserve Act, 12 U. S. C. A. 248 (*m*)).

The required balance carried by a member bank with a Federal reserve bank may, under the regulations and subject to such penalties as may be prescribed by the the Federal Reserve Board, be checked against and withdrawn by such member bank for the purpose of meeting existing liabilities; provided, however, that no bank shall at any time make new loans or shall pay any dividends unless and until the total balance required by law is fully restored (Section 19 of the Federal Reserve Act, 12 U. S. C. A. 464).

APPENDIX B.

Regulation J, Series of 1924.

(Superseding Regulation J of 1920.)

Check Clearing and Collection.

SECTION I. Statutory Provisions.

Section 16 of the Federal Reserve Act authorizes the Federal Reserve Board to require each Federal re-

serve bank to exercise the function of a clearing house for its member banks, and section 13 of the Federal Reserve Act, as amended by the act approved June 21, 1927, authorizes each Federal reserve bank to receive from any nonmember bank or trust company, solely for the purpose of exchange or of collection, deposits of current funds in lawful money, national bank notes, Federal reserve notes, checks and drafts payable upon presentation, or maturing notes and bills, provided such nonmember bank or trust company maintains with its Federal reserve bank a balance sufficient to offset the items in transit held for its account by the Federal reserve bank.

SECTION II. General Requirements.

In pursuance of the authority vested in it under these provisions of law, the Federal Reserve Board, desiring to afford both to the public and to the various banks of the country *a direct, expeditious, and economical system of check collection and settlement of balances,* has arranged to have each Federal reserve bank exercise the functions of a clearing house and collect checks for such of its member banks as desire to avail themselves of its privileges and for such nonmember State banks and trust companies as may maintain with the Federal reserve bank balances sufficient to qualify them under the provisions of section 13 to *send* items to Federal reserve banks for purposes of exchange or collection. Such nonmember State banks and trust companies will hereinafter be referred to as nonmember clearing banks.

Each Federal reserve bank shall exercise the functions of a clearing house and collect checks under the general terms and conditions hereinafter set forth.

SECTION III. Checks Received for Collection.

(1) Each Federal reserve bank will receive at par from its member banks and from nonmember clearing banks in its district, checks drawn on all member and nonmember clearing banks, and checks drawn on all other nonmember banks which are collectable at par in funds acceptable to the Federal reserve bank of the district in which such nonmember banks are located.

(2) Each Federal reserve bank will receive at par from other Federal reserve banks, and from all member and nonmember clearing banks in other Federal reserve districts which are authorized to route direct for the credit of their respective Federal reserve banks, checks drawn on all member and nonmember clearing banks of its district, and checks drawn on all other nonmember banks of its district which are collectible at par in funds acceptable to the collecting Federal reserve bank.

(3) No Federal reserve bank shall receive on deposit or for collection any check drawn on any nonmember bank which can not be collected at par in funds acceptable to the Federal reserve bank of the district in which such nonmember bank is located.

SECTION IV. Time Schedule and Availability of Credits.

(1) Each Federal reserve bank will publish a time schedule showing the time at which any item sent to it will be counted as reserve and become available for withdrawal or other use by the sending bank. For all checks received, the sending bank will be given immediate credit, or deferred credit, in accordance with such time schedule, and as provided below.

(2) For all such checks as are received for immediate credit in accordance with such time schedule, immediate credit, subject to final payment, will be given upon the books of the Federal reserve bank at full face value in the reserve account or clearing account upon day of receipt, and the proceeds will at once be counted as reserve and become available for withdrawal or other use by the sending bank.

(3) For all such checks as are received for deferred credit in accordance with such time schedule, *deferred credit, subject to final payment,* will be entered upon the books of the Federal reserve bank at full face value, but the proceeds will not be counted as reserve nor become available for withdrawal or other use by the sending bank *until such time as may be specified in such time schedule,* at which time credit will be transferred from the deferred account to the reserve account or clearing account subject to final payment and will then be counted as reserve and become available for withdrawal or other use by the sending bank.

SECTION V.—Terms of Collection.

The Federal Reserve Board hereby authorizes the Federal reserve banks to handle such checks subject to the following terms and conditions; and each member and nonmember clearing bank which *sends* checks to any Federal reserve bank for deposit or collection shall by such action be deemed (*a*) to authorize the Federal reserve banks to handle such checks subject to the following terms and conditions, (*b*) to warrant its own authority to give the Federal reserve banks such authority, and (*c*) to agree to indemnify any Federal reserve bank for any loss resulting from the failure of such sending bank to have such authority.

(1) A Federal reserve bank *will act only as agent* of the bank from which it receives such checks *and will assume no liability except for its own negligence* and its guaranty of prior indorsements.

(2) A Federal reserve bank may present such checks for payment or *send such checks for collection direct to the bank on which they are drawn* or at which they are payable, or in its discretion may forward them to another agent with authority to present them for payment or send them for collection direct to the bank on which they are drawn or at which they are payable.

(3) A Federal reserve bank may in its discretion and at its option, either directly or through an agent, *accept either cash or bank drafts in payment of or in remittance for such checks and shall not be held liable* for any loss resulting from the acceptance of bank drafts in lieu of cash, nor *for the failure of the drawee bank or any agent to remit for such checks,* nor for the nonpayment of any bank draft accepted in payment or as a remittance from the drawee bank or any agent.

(4) Checks received by a Federal reserve bank on its member or nonmember clearing banks will ordinarily be forwarded or presented direct to such banks, and such banks will be required *to remit or pay therefor at par in cash or bank draft* acceptable to the collecting Federal reserve bank, *or* at the option of such Federal reserve bank *to authorize such Federal reserve bank to charge their reserve accounts or clearing accounts;* provided, however, that any Federal reserve bank may reserve the right in its check collection circular to charge such items to the reserve account or clearing account of any such bank at any time when in any particular case the Federal reserve bank deems it necessary to do so.

(5) Checks received by a Federal reserve bank payable in other districts will be forwarded for collection upon the terms and conditions herein provided to the Federal reserve bank of the district in which such checks are payable.

(6) The amount of any check for which payment in actually and finally collected funds is not received *shall be charged back to the forwarding bank,* regardless of whether or not the check itself can be returned.

SECTION VI.—Other Rules and Regulations.

Each Federal reserve bank shall also promulgate rules and regulations not inconsistent with the terms of the law or of this regulation, governing the details of its check clearing and collection operations. Such rules and regulations shall be set forth by the Federal reserve banks in their letters of instruction to their member or nonmember clearing banks and shall be binding upon any member or nonmember clearing bank which *sends* any check to such Federal reserve bank for collection or to any other Federal reserve bank for the account of such Federal reserve bank for collection.

BRIEF IN SUPPORT OF PETITION FOR WRIT OF CERTIORARI.

I.

The Opinions of the Courts Below.

The order of judgment made by the District Judge (R. 11) is not officially reported.

The opinion in the Circuit Court of Appeals, 4th Circuit (R. 68), is officially reported in 30 Fed. (2d) 198.

A petition for rehearing was filed and this was refused by formal order filed of date April 9th, 1929 (R. 94).

II.

Jurisdiction.

1. The statutory provision believed to sustain the jurisdiction is Judicial Code 240, as amended by the Act of February 13th, 1925 (12 U. S. C. A., 347 (*a*)), as follows:

> "In any case, civil or criminal, in a Circuit Court of Appeals, or in the Court of Appeals of the District of Columbia, it shall be competent for the Supreme Court of the United States, upon the petition of any party thereto, whether Government or other litigant, to require by certiorari, either before or after a judgment or decree by such lower court, that the cause be certified to the Supreme Court for determination by

it with the same power and authority, and with like effect, as if the cause had been brought there by unrestricted writ of error or appeal."

2. The decision sought to be reviewed was first filed on January 14th, 1929. A petition for rehearing being, however, presented to the Circuit Court, the order denying the petition was filed of date April 9th, 1929 (R. 94).

3. The decision of the Circuit Court of Appeals is in effect a final judgment in the cause. The case was tried on a stipulation of facts and the record on the second trial will of necessity be exactly the same as it was on the first trial. Therefore, while the decision of the Circuit Court is not final in form, it is unquestionably final in character, as it conclusively determines the judgment to be entered up in the court below. Especially in view of the public interests involved,—with the great volume of check collections throughout the entire country now being handled through the Federal Reserve System under the provisions of the Federal Reserve Act and the regulations issued pursuant thereto by the Federal Reserve Board,—a prompt decision by this court is, we respectfully submit, of such importance that a writ of certiorari ought to be allowed at this stage of the proceedings without further protracting the litigation to the extent that it would be necessary in order to reach final judgment.

4. The following cases are believed to sustain the jurisdiction and to justify the application for cer-

tiorari, notwithstanding the Circuit Court of Appeals remanded the case for a new trial:

United States *v.* Gulf Refining Co., 268 U. S. 542.
Spiller *v.* Railroad, 253 U. S. 117.
Forsyth *v.* Hammond, 166 U. S. 506.
American Const. Co. *v.* Railroad, 148 U. S. 372.

In the Gulf Refining Co. case it was said:

> "And the petition may be granted, notwithstanding the Circuit Court of Appeals remanded the case for a new trial and did not render a final judgment therein."

In the Spiller case it was said:

> "* * * upon the consideration of the particular circumstances of the case, we have concluded that a writ of certiorari ought to be allowed, without further protracting the litigation to the extent that it would be necessary in order to reach final judgment."

III.

Statement of the Case.

The summary statement of the matter involved, as made in the petition, covers the main material facts. A brief analysis of the Federal Reserve System of check clearing and collection may perhaps aid understanding of the situation of the parties and bring out more clearly the nature of the obligation assumed by the Lake City bank in respect to the checks forwarded for collection.

In rewriting Regulation J, following the decision in Federal Reserve Bank *v.* Malloy, 264 U. S. 160, the apparent object was to give the Federal reserve banks a greater latitude of discretion, with more complete protection against liability in carrying out the expressed policy of "a direct, expeditious and economical system of check collection." The clearing-house facilities of the Federal reserve bank were made available—(1) to all member banks desiring to avail themselves of such privileges, and (2) to nonmember banks and trust companies, subject, however, to the requirement that any such nonmember bank or trust company should maintain with its Federal reserve banks "a balance sufficient to offset the items in transit held for its account by the Federal reserve bank" (Appendix B).

Each reserve bank was required to publish a time schedule showing the time at which any item sent by it would be counted as reserve and become available for withdrawal or other use by the sending bank. Section IV (1). For checks drawn on South Carolina banks, this was three days (R. 57). Deferred credit was given to the sending bank in accordance with the time schedule, subject to final payment, but the proceeds not to be counted as reserve nor to become available for withdrawal or other use by the sending bank until the time specified in the time schedule, Section IV (3).

The terms of collection, specified at length in section V, required the forwarding banks to take every risk of the clearance. The provisions contained—(*a*) express notice that the reserve bank "*will act only as agent,*" and "*will assume no liability except for its*

own negligence;" (*b*) advice to the forwarding banks that the reserve bank will, in its discretion, send checks *direct* to the banks on which they are drawn,—regardless of whether the drawee banks are member banks or nonmember clearing banks; (*c*) advice to both the forwarding and remitting banks outlining acceptable methods of payment or remittance for the collection items; (*d*) advice to the remitting banks of the alternative method of remitting for the collection, optional to the reserve bank, "to *authorize* such Federal reserve bank to charge their reserve or clearing accounts"; (*e*) advice to the forwarding banks that unless payment is received "in actually and finally collected funds," the amount of *the uncollected check will be charged back,* "regardless of whether or not the check itself can be returned" (R. 45-46).

The "cash letter" method of handling the collection items is not dependent upon the state of the reserve or clearing accounts of the banks on which the checks are drawn. So far as any requirement or assurance of the check collection regulations is concerned, checks may also be sent direct to banks that have no reserve or clearing accounts and that are not even affiliated with the clearing system. See American Bank & Trust Co. *v.* Federal Reserve Bank, 262 U. S. 643. Even as to the banks having reserve or clearing balances against which the checks are declared to be chargeable, the particulars of the balances could not be known to the owners of the checks.

The lack of reliance to be placed on the reserve balances as a special fund or security for the collection

items in transit is obvious in the present case on examination of the ledger entries (R. 64-65). The reserve balance on the morning of October 8th was $32,196.00; charges against the deposit account of the 8th, $33,565.00; with $28,150.00 as credits. The balance on the 9th was $26,781.00; charges, $21,848.00; credits, $17,153.00. On the 11th, after the bank had closed, the balance (corrected) was $22,088.00, or lacking $12,982.85 of being enough to meet the cash letters outstanding (R. 32-33). The entries between the dates of September 23rd and September 27th are even more illustrative of the uncertainties of the reserve balance. On September 24th over $40,000.00 in collection items were apparently outstanding against the Lake City Bank, with the reserve balance then depleted to $2,880.00. Following withdrawals of over $60,000.00 on the 23rd, substantial deposits were made within the next few days and the cash letters, which on the 24th had practically no protection so far as the reserve deposit was concerned, were regularly met when they became chargeable.

Substantial balances may exist today; are gone tomorrow; are restored; the cash letters are paid; and the bank carries on. Or, on the other hand, the substantial balance which exists when the checks are dispatched for collection, and even when the checks are accepted, may be drawn out in a day's business; and, from the standpoint of security to the owner of the collection items, the intangible substance of the evanescent balance has faded into nothingness when the bank fails.

IV.

Specification of Errors.

1. The Circuit Court erred in the underlying premise upon which the opinion rests in holding that:

> "The checks were sent to the drawee (the Lake City Bank) upon the distinct and definite agreement that they were to be paid out of the funds of the reserve account of the drawee by charging them to that account."

2. The Circuit Court erred in the conclusion stated in the opinion that:

> "Although in this case the transit period had not ended at the time of the closing of the drawee bank, the rights of the owners of the checks to have them charged against the reserve balance of the drawee had become fixed and irrevocable."

The opinion states the material question in issue:

> "Whether the deposit balance in favor of the insolvent bank should be applied on the checks in question, as contended by the Reserve Bank?"

At the outset of its discussion of this question, the court assumed the conclusion, in substance, as follows:

> The right of the owners of the checks to demand that they be charged against the drawee's account and that the balance of that account be applied by the Reserve Bank to their payment, became fixed, so as to constitute it a charge upon the reserve balance, when the checks were

accepted by the drawee, and charged to the account of the various drawers.

The reason for assuming the foregoing conclusion does not, however, appear until almost at the end of the opinion, the following the holding that the case of Equitable Trust Co. *v.* First National Bank of Trinidad, 275 U. S. 359, is not authority against the position of the Reserve Bank (R. 75). In making that declaration and for the purpose of distinguishing the facts of the present case from the Bank of Trinidad case, the court stated the premise which, as above pointed out, we believe to be erroneous and unfounded and which, from the error therein, has naturally resulted in an erroneous decision.

V.

ARGUMENT.

Summary of Argument.

The petitioner contends:

A.

That there was neither agreement of the parties nor understanding implied from the terms of collection equitably to assign any part of the reserve balance or to treat such balance as a specified fund pledged as security to the payment of the accepted checks.

B.

That the exercise of the clearing-house functions of the Reserve Bank was not based upon the faith of the

reserve balances and the authority of the Reserve Bank to make charges against the reserve account of the drawee bank was revoked by the insolvency of such bank.

C.

That the principles declared by this court in Equitable Trust Co. *v.* First National Bank of Trinidad, 257 U. S. 359, should have been held by the Circuit Court to be controlling against the position of the Reserve Bank.

POINT A.

There was neither agreement of the parties nor understanding implied from the terms of collection to create an equitable lien or charge on the Reserve balance as security for the payment of the checks.

The assignment of the reserve balance, if it existed, has to be implied from the terms of collection under which the checks were handled. The acceptance of the checks by the drawee bank was not followed either by setting apart a specified sum to meet their payment or by express assignment of any part of the reserve balance. There were no unusual circumstances of the transaction. No assurance was given that the particular fund in the reserve account should be the source from which payment should be made. The cash letters under which the checks were forwarded contained

merely the notation that two business days later they would become *"chargeable against available balance in reserve account."* An assent to these terms carried with it neither tender of security nor any representation other than the understanding that the drawee bank would, at its convenience within the agreed transit time, provide funds to make the payment at the Reserve Bank.

It said, however, that the check collection circular, prescribing the terms of collection, establishes the right to make the charge as contended by the Reserve Bank. But this circular letter plainly states that the drawee bank has *"within the agreed transit time"* the right *"either* to remit * * * *or* to provide funds available to us (the Reserve Bank) to meet such cash letters." The provision then follows:

> *"Therefore, the amount of any cash letter to a member bank is chargeable against available funds in the reserve account of such member at the expiration of such transit time, which date will be shown on each cash letter."*

The case of Fourth Street Bank *v.* Yardley, 165 U. S. 634, is cited in the Circuit Court opinion as authority for its position, quoting in part as follows:

> "* * * yet the authorities establish that if in the transaction connected with the delivery of the check it was the understanding and agreement of the parties that an advance about to be made should be a charge on and be satisfied out of a specified fund, a court of equity will lend its aid to carry such agreement into effect * * *."

It will be noted, however, from the quotation that even the equitable relief afforded by a court of equity in the Yardley case was dependent upon the understanding and agreement of the parties that an advance about to be made *"should be a charge on and be satisfied out of a specified fund."* The error of the Circuit Court in assuming that the position taken by the Reserve Bank falls within the principle announced in the Yardley case clearly appears, we think, upon examination of the circumstances stated in the opinion as follows:

> "The transaction, therefore, was a proposition to borrow on the one hand, accompanied with the disclosure that security was necessary and tendering the security, and, on the other hand, an acceptance of such proposal and an advance made on the faith of it. * * *
>
> "It is impossible to infer otherwise that it was intended that the particular fund in the Tradesmen's Bank should be not only the source from which the payment of the check to be given should be made, but that the funds should be transferred and appropriated pro tanto for that purpose. * * *
>
> "As the Fourth Street Bank contracted and parted with its money on the faith of the representations of the Keystone Bank that there was to its credit, in the Tradesmen's Bank, a *specific sum,* and the fund which came into the hands of its voluntary assignee is this fund as to which the representations were made, the Keystone Bank and its assignee are in equity estopped from asserting, to the prejudice of the Fourth Street Bank, that the character and

condition of the fund was otherwise than it was represented to be" (165 U. S. 651-653).

The ordinary clearance transaction in the case at bar presents none of the elements appearing in the above stated facts, where there was (1) a proposition to borrow; (2) a disclosure that security was necessary; (3) tendering the security; (4) the acceptance of such proposal and an advance made on the faith of it; and, (5) the intention that the particular fund in the Tradesmen's Bank should be not only the source from which the payment of the check should be made, but that the funds should be transferred and appropriated pro tanto for that purpose.

In the case at bar we find the following salient features—(1) the recognized right of the drawee bank to use its reserve account for general purposes during the period between the acceptance of the collection items and the expiration of the transit time, which date was shown on each cash letter; and, (2) the right of the drawee bank *either* to remit, *or* to provide funds, at its own convenience, subject only to the simple unsecured agreement, *"to meet such cash letters within the agreed transit time to and from the member bank."*

THE PRINCIPLES GOVERNING EQUITABLE LIENS.

Any order, writing, or act which makes an appropriation of a fund amounts to an equitable assignment of the fund. Spain *v.* Brent, 1 Wall. 604.

An agreement to pay out of a particular fund, however clear its terms, is not an equitable assignment, if

the assignor retains any control over the fund. Christmas *v.* Gaines, 14 Wall. 69; Meyer *v.* Delaware R. Constr. Co., 100 U. S. 457.

An agreement to remit for collection items, even where the remittance is to be made by draft or a charge against a particular deposit account, does not constitute an assignment or create an equitable charge against the deposit. Christmas *v.* Gaines, 14 Wall. 69.

In the interborough Consolidated Corporation case, 288 Fed. 334, 32 A. L. R. 932, 947 (certiorari denied, 262 U. S. 752, 67 L. Ed. 1215), it is said:

> *"A particular fund is not 'charged' unless it is bound for the performance of an obligation imposed."*

The application of the same principle is found in Woodhouse *v.* Crandall, 197 Ill. 104, 58 L. R. A. 385, where it is said:

> "The banking firm assumed the position of a trustee and the money deposited constituted a trust fund *which the bank was bound to keep intact for the purpose of the trust."*

In Pomeroy's Equity Jurisprudence (4th ed.) section 1235, a statement of the conditions under which equitable liens or charges may be created is made as follows:

> "In order, however, that a lien may arise in pursuance of this doctrine, the agreement must deal with some particular property, either by identifying it, or by so describing it that it can be identified, *and must indicate with sufficient*

> *clearness and intent that the property so described, or rendered capable of identification, is to be held, given or transferred as security for the obligation."*

So, in the case of United States *v.* Butterworth-Judson Corp., 262 U. S. 387, an equitable charge was held to be established by the deposit of money "in *special* accounts in banks *separate* from its other funds," to be drawn upon only for specific purposes. The basis of decision is stated in the opinion of Mr. Justice Butler as follows:

> *"The agreement made the balances in the special accounts security* for the obligations of the contractor, and so created an equitable lien * * * The purpose and effect of the special accounts was * * * *to limit the use of the funds to the purposes specified,* and so to make it available as security."

POINT B.

The exercise of the clearing functions of the Reserve bank was not based on the faith of the Reserve balance of the member bank.

The Federal Reserve Act originated in the need of stabilizing financial conditions. The requirement of reserve balances was designed primarily to provide available funds for the Federal reserve banks to take care of the financial needs of their member banks; the existence of which depended on the resources available to them and on the protection afforded to their

depositors. To give this protection was the main—because the most vital—object of the banking provisions. Reserves were necessary to safe banking. Each member bank was required to contribute his proportionate part to the strength of the financial system.

Under the terms of the Federal Reserve Act the exercise of clearing house functions was permissive but not mandatory (12 U. S. C. A. 248 (*m*)). This was seemingly considered as a minor part of the reserve system activities. There is no indication from any of the provisions of the act that clearing house functions of the system were even remotely in mind so far as the statutory provision for reserve balances was concerned.

The use of the reserve balance in the clearing system facilitated the handling of the collection items, simplifying the method of clearing. The reserve account is not a special account. Subject to prescribed penalties the reserve balance may be checked against and may even be completely withdrawn (12 U. S. C. A. 464); and the amount of the available balance at the expiration of the transit period is necessarily dependent on the extent of withdrawals and deposit occurring after the acceptance of the checks.

No limitation is made to preclude other use of reserve balance. No deposit is made, nor funds set apart, to be kept separate from other funds for the purpose of providing security for the handling of the collection items. On the contrary, the reserve balance, not being made specifically applicable to clearing purposes, is not required to be sufficient to cover the

items in transit held against the account of the depositor. It can be drawn upon by the depositor to meet the payment of other obligations. It can be applied by the reserve bank to the payment of the indebtedness of the depositor to itself.

There is no requirement that balances be carried for the purpose of meeting demands in transit; and the duty as declared in the check collection circular to provide available funds in the reserve account is without security for its performance.

Neither the amount of balances usually carried nor the probable extent of withdrawals nor the particulars of the balance at any given time are known to the owners of items when they use the Federal reserve system for the purpose of collections.

Checks drawn on nonmember and non-affiliated banks which have neither reserve nor clearing accounts are received for collection by the reserve banks and may be sent direct to the drawee bank. Consent that the checks be surrendered and the drawers released is based on nothing more than the mere contractual duty to remit by cash or bank draft,—subject to the hazard of possible insolvency of the drawee bank before the remittance is completed by the final collection.

THE AUTHORITY OF THE RESERVE BANK TO WITHDRAW FUNDS FROM THE RESERVE ACCOUNT OF ITS MEMBER BANK WAS REVOKED BY THE INSOLVENCY OF THE MEMBER BANK.

Nothing had been done toward the exercise of the right to make the charge against the reserve balance until after notice had been received that the Lake City

Bank had closed its doors. The subsequent appropriation of the reserve balance of the insolvent bank must necessarily stand on exactly the same footing as if made by its own officers. The act of the Reserve Bank in charging the member bank's reserve balance, as authorized by the regulation, has the same significance, and is exactly the same in practical results, as the act of a member bank itself in giving an order to the reserve bank by a check drawn on its reserve account to transfer funds from the account to meet the payment. Either act can be done before the bank closes, but not afterwards.

The conditions existing at the moment of insolvency could not be changed or altered by subsequent acts,—either those done by officers of the insolvent bank or those done in its name by the reserve bank under its power of attorney. The rights of the depositors and general creditors of the drawee bank to a pro rata distribution in all of its unpledged assets had become fixed at the moment of insolvency, and the attempt subsequently to create a favored class of creditors was utterly null and void.

12 U. S. C. A. 91.

Scott *v.* Armstrong, 146 U. S. 499.

An interest in the property upon which the power is to operate, and not merely an interest in the exercise of the power is essential to make a power of attorney one coupled with an interest so as not to be subject to revocation.

Taylor *v.* Burns, 203 U. S. 120.

In Hunt *v.* Rousmanier's Admr's, 8 Wheat. 174, 205, Chief Justice Marshall said:

> *"The interest or title in the thing being vested in the person who gives the power, remains in him, unless it be conveyed with the power, and can pass out of him only by a regular act in his own name. The act of the substitute, therefore, which in such a case is the act of the principal, to be legally effectual, must be in his name—must be such an act as the principal himself would be capable of performing, and which would be valid if performed by him."*

The foregoing principles are given application in the Columbia Shoe Co. case, 289 Fed. 465 (C. C. A. 2d Circuit), where the court, holding that the agreement previously made had been revoked by insolvency, said:

> "The power of attorney of April 27th added nothing to title. If anything it denied title. It merely permitted Speigel to act as attorney in fact for Columbia Shoe Co., so as to enable Speigel to make collections and to deposit in the corporation's name and to draw drafts, etc. in its name. This power of attorney was not in any sense coupled with an interest. Such a power, of course, presupposes a legal interest in the *res* of which the power is to be executed.
> • • •
> *"When the petition was filed the property of the bankrupt was in custodia legis, and the power of attorney was revoked by operation of law.* Mueller *v.* Nugent, 184 U. S. 1, 46 L. ed. 405; Lazarus *v.* Prentice, 234 U. S. 263, 58 L. ed. 1035."

Point C.

The decision of this Court in Equitable Trust Co. v. First National Bank of Trinidad, 257 U. S. 359, is authority against the position of the Reserve bank.

The settlement for the collection of the checks handled through the Federal clearing house system was to be made through the Reserve Bank which thus became, in effect, the drawee bank for the purpose of clearing the remittances. The funds when placed in the hands of the Reserve Bank would become available to be drawn upon by the owner of the collection items. The agreement of member banks,—under the rules of the clearing system,—to remit for items upon themselves can be fairly stated by using the words of Mr. Justice Holmes from the Bank of Trinidad opinion: "They are to provide the drawee banks (the Federal reserve banks) with sufficient funds for the payment *by transfer of credit from our balance 'or otherwise'*; they are to provide, that is, as convenient to themselves, for payment to the drawee banks (the Federal reserve banks), *not to give them an earmarked corpus to be handed over.*" The agreement does not set apart the deposit belance of the member bank as security for payment of the collection items; nor does it promise the appropriation of a specified fund.

It therefore seems to us that we are well justified in believing that the bank of Trinidad decision has a direct and controlling application in respect to the case at bar. The sole question there at issue was

whether a *special* account had been established and the use of the funds irrevocably limited to the purposes specified. The Circuit Court of Appeals, Second Circuit, 13 Fed. (2d) 732, 735, held that the equitable charge had been created by the agreement and acts of the parties, saying:

> "It seems to us the agreement to transfer the credit, *followed by its actual transfer,* provided a fund which the drawee was obliged to devote to the payment of the draft; that is, that it created an equitable assignment or an irrevocable declaration of trust by the bankrupts."

A writ of certiorari was applied for and was granted by this Court. In many respects the points made by the petitioner on his application for writ of certiorari are very similar to those upon which the petitioner in the present case has based his application. Upon the hearing of the cause, the court divided. The majority opinion, written by Mr. Justice Holmes, stated the conclusion that the transaction did not constitute the appropriation of funds for a specific use and did not show an intent to establish—

> "an attenuated property right in an account to which no special funds were attached and the particulars of which neither the respondent nor the purchaser of the check could know."

The analysis of the case made by Mr. Justice Holmes shows a consideration of three salient factors leading to this conclusion as follows: (1) the ignorance of the whole affair on the part of the holder; (2)

the general understanding that the account was subject to the bankrupt's control; and (3) that—

> "the terms offered by the bankrupt to their correspondents seem to us to promise the appropriation of a specified fund to the draft as little as they promise to apply the money received by them to that end. They are to provide the drawee bank with sufficient funds for the payment of the drafts by transfer of credit from our balance 'or otherwise'. They are to provide, that is, as convenient to themselves, for payment by the drawee bank, *not to give them an earmarked corpus to be handed over.* * * *"

For the purpose of comparison with the facts entering into the present situation, the three contractual elements of the banking transaction above reviewed will be summarized: (1) the agreement of the insolvent bank to provide sufficient funds to meet payment of the items; (2) the authority, or power of attorney, to the bank in which the funds of the insolvent bank were held on general deposit to make an appropriation of such funds for the purpose of payment; and (3) the setting apart of funds,—under such authority or power of attorney and in accordance with the standing agreement between the insolvent bank and the bank in which the deposit account was carried,—to a special "Drafts Payable" account for the purpose of meeting the items in transit.

Here we find,—under the provisions of Regulation J and the check collection circular issued pursuant thereto,—only the agreement to provide funds, and

the authority, or power of attorney, to make an appropriation of such funds for the purpose of the payment. The sole requirement of the insolvent bank was to provide sufficient funds to meet the payment of the checks at a later specified date, by transfer of credit from available funds in the reserve account 'or otherwise'. It was to provide these funds *in such manner as might be convenient to itself* within the three day transit transit period,—not to furnish upon the acceptance of the check, either "an earmarked corpus to be handed over", or "an attenuated property right in an account to which no special funds were attached."

In the Bank of Trinidad case the money was directly deposited with the bankrupt upon the agreement that it should be paid over to the owner through the clearing bank by establishing a credit which would be subject to the drafts of the owners of the money. In the case at bar, the owners of checks drawn on the bankrupt deposited the checks with the clearing bank for collection upon the agreement that, on the collections being made, the credit thereby established at the clearing bank would be subject to the drafts of the owners of the money.

The theory of a distinction between the two cases, as held by the Circuit Court of Appeals, seems somewhat difficult to follow in considering the application of the principles involved in the Bank of Trinidad opinion.

The division of opinion in the Bank of Trinidad case arose because of circumstances which were believed in the minority opinion to show the complete

performance of the bankrupt's agreement to provide funds, by setting apart in a special "Drafts Payable" account enough of its credit with the clearing bank to meet the payment of the items in transit. This feature of the Bank of Trinidad case, which was the basis of decision in the Circuit Court and also the basis of the minority opinion in this Court, is altogether lacking in the case now presented; and the agreement to provide funds stands by itself, without anything having been done to carry the agreement into effect until after the act of insolvency had occurred.

Conclusion.

The insolvent bank had no part in the preparation of the check collection circular, and even if it was susceptible of the meaning for which the Reserve Bank, its application would be governed, and the rights of the parties determined, by the rule that *doubt must be resolved against the party whose language becomes necessary to construe.* Moulor *v.* Insurance Co., 111 U. S. 335, 28 L. ed. 447. Ambiguities in a contract which was drawn by the attorneys, officers or agents of one of the parties, should be resolved, if it can be done consistently with the objects for which the contract is made, in favor of the other party. American Surety Corp. *v.* Pauly, 170 U. S. 133, 42 L. ed. 977.

In view of the nature of the case and the public interests involved in the determination of the question, it is, therefore, respectfully submitted that this case is one calling for the exercise by this Court of its su-

pervisory powers, and that to such end a writ of certiorari should be granted and this Court should review the decision of the Circuit Court and finally reverse it.

R. E. WHITING,
Counsel for Petitioner.

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SUPREME COURT OF THE UNITED STATES.

OCTOBER TERM, 1929.

No. 226

THOMAS A. EARLY, RECEIVER OF THE FARMERS & MERCHANTS NATIONAL BANK OF LAKE CITY, PETITIONER,

v.

FEDERAL RESERVE BANK OF RICHMOND, RESPONDENT.

BRIEF OF PETITIONER.

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SUPREME COURT OF THE UNITED STATES.

OCTOBER TERM, 1929.

No. 226

THOMAS A. EARLY, Receiver of the Farmers & Merchants National Bank of Lake City, Petitioner,

v.

FEDERAL RESERVE BANK OF RICHMOND, Respondent.

BRIEF OF PETITIONER.

I.

The Opinions of the Courts Below.

The order of judgment made by the District Judge (R. p. 11) is not officially reported.

The opinion of the Circuit Court of Appeals, Fourth Circuit (R. p. 68) is officially reported in 30 Fed. (2) 198.

II.

Jurisdiction.

Writ of certiorari was granted October 21, 1929.

III.

Statement of the Case.

A. *The Proceedings Below and the Issue.*

Suit was filed, at law, in the District Court of the United States for the Eastern District of South Carolina by the Receiver of the Farmers and Merchants National Bank of Lake City, South Carolina (hereinafter referred to as the Lake City Bank), against the Federal Reserve Bank of Richmond (hereinafter referred to as the Reserve Bank), on two causes of action: (1) to recover a reserve deposit balance of $22,088.48 alleged to have been owing by the Reserve Bank to the Lake City Bank at the time of the failure and suspension of the latter; (2) to recover the sum of $4,115.15, constituting the surrender value, with accrued dividends, of 78 shares of stock in the Reserve Bank owned by the Lake City Bank at the time of its failure (R. pgs. 1-4). The Reserve Bank admitted the amount of the deposit balance and of the surrender value of the stock, but claimed the right to apply the same toward the payment of certain checks drawn on the Lake City Bank which the Reserve Bank had received for collection from its customer banks and under its rules had

forwarded to the Lake City Bank for payment, the checks having been thereafter received by the Lake City Bank and canceled, but failure and suspension of the Lake City Bank having intervened before remittance or payment to the Reserve Bank had been made by the Lake City Bank for said checks. The aggregate amount of said deposit balance and of said surrender value of said stock was substantially less than the amount of the checks so forwarded by the Reserve Bank to the Lake City Bank, and the Reserve Bank, in addition to asserting the right to apply said deposit and said surrender value of said stock toward payment for said checks, also filed counter-claim against the Receiver for the deficiency (R. pgs. 4-9).

Jury was waived and the case was tried upon a stipulation of facts (R. pgs. 10-11; 15-23), certain letters and documents also being introduced in addition to the agreed statement of facts (R. pgs. 23-35).

Judgment was entered in favor of the Receiver for recovery of the deposit, and for the surrender value of the stock, with interest (R. pgs. 11-14), and the Reserve Bank appealed to the Circuit Court of Appeals.

The Circuit Court of Appeals reversed the Trial Court on the first cause of action, relating to the deposit balance, holding, in substance, that under the collection contract an equitable charge or lien existed against the deposit balance in favor of the owners of the checks forwarded to the Reserve Bank for collection and that consequently the Reserve Bank properly applied the deposit balance toward satisfaction of such equitable charge or lien (R. pgs. 68-76).

Judgment was affirmed on the second cause of action relating to the surrender value of the stock, the Circuit Court of Appeals holding, in substance, that inasmuch as the Reserve Bank had received the checks in question as agent for collection, *the amounts due for said checks were owing, not to the Reserve Bank, but to the customers of the Reserve Bank, and that consequently there was no mutuality permitting a set-off*, and the Reserve Bank could not, as agent for collection, set off the amount owing under said checks against the amount which it owed to the Receiver of the Lake City Bank for the surrender value of said stock (R. pgs. 76-77).

The reversal of the Trial Court on the first cause of action, relating to the deposit account, although awarding a new trial, was final in substance and conclusive upon the Trial Court in respect to the judgment to be entered in the cause, and it was for the purpose of obtaining a review of this portion of the Circuit Court of Appeals' decision that the application for writ of certiorari was made.

The Issue.

It is the contention of the Receiver that the collection contract did not raise an equitable lien or charge against the reserve deposit of the failed bank, and that suspension of the bank fixed the status of its reserve deposit as part of its general assets, and that no charges could thereafter be made by the Reserve Bank to deplete such deposit account for the purpose of giv-

ing the customers and depositors of the Reserve Bank a preferred status at the expense of the general creditors of the Lake City Bank.

B. *The Facts Concerning the Collection Contract.*

The Reserve Bank had received the checks in question from its customers as a collection agent, and had transmitted the same to the Lake City Bank (R. pgs. 15, 17, 18) under the clearing and collection system which the Reserve bank had established by virtue of its authority to act as a clearing house for its member banks, as permitted by Section 16 of the Federal Reserve Act (12 U. S. C. A. 248 (*m*)), and Regulation J, Series of 1924, promulgated by the Federal Reserve Board (R. p. 43). The details of its collection system were set forth in a letter of instructions to member banks known as "Circular No. 143," issued by the Reserve Bank under authority of said Regulation J, Series of 1924 (R. p. 47). For convenience of reference, the pertinent statutory provisions, and Regulation J, Series of 1924, are, respectively, set out in full in Appendices A and B of this brief. Section VI of said Regulation J authorizes the issuance by a Reserve bank of such collection circulars for the purpose of "governing the details of its check clearing and collection operations", and provides that said circulars or letters of instruction

> "Shall be binding upon any member or non-member clearing bank which sends any check to such Federal Reserve Bank for collection * * *" (R. P. 47).

The Circuit Court of Appeals summarized certain features of this collection system in the following language:

> "This collection system, which was agreed to by the forwarding banks as well as by the banks upon which the checks were drawn, was characterized, so far as the checks here are concerned, by the following provisions: (1) The Reserve Bank was acting only as agent of the forwarding banks and assumed no liability except for its own negligence; (2) it was authorized to send the checks direct to the drawee bank for collection; (3) the amount of any check for which payment 'in actually and finally collected funds' was not received by the Reserve Bank was authorized to be charged back to the forwarding bank, regardless of whether or not the check itself could be returned; and (4) the checks, unless promptly returned by the drawee bank, were to be charged to its account with the Reserve Bank at the expiration of a designated transit time, in this case three days, but the latter bank reserved the right to so charge them at any time when in any particular case it was deemed necessary to do so * * *" (R. p. 69).

In addition it may be noted that Section IV of Regulation J requires each Reserve Bank to publish a schedule showing the time at which any item sent to it will be counted as reserve and become available for withdrawal or other use by the sending bank (R. p. 45) and that the time schedule fixed by the Federal Reserve Bank of Richmond for checks drawn on South Carolina was three days (R. pgs. 57-58). *Checks received*

by a Reserve Bank for collection are transmitted to its member drawee bank in a letter generally designated as a "cash letter." In the instant case the Reserve Bank forwarded on October 7, 1926 to the Lake City Bank, a *cash letter* containing checks drawn against the latter amounting to $14,900.62 (less checks dishonored and returned). On October 8, 1926 the Reserve Bank forwarded a cash letter containing checks drawn upon the Lake City Bank amounting to $20,-170.71 (less checks dishonored and returned). The Lake City Bank received the first cash letter on October 8th and the second on October 9th, and immediately acknowledged receipt of them to the Reserve Bank, the accepted checks being charged by the Lake City Bank to the accounts of the various drawers and marked "paid" (R. pgs. 17-18), and the aggregate amount of the checks in each cash letter being credited to a memorandum account pending the expiration of the three day transit period, the practice being to credit the amounts of such checks to the Reserve Bank at the *expiration of the transit time* (R. pg. 16), *assuming, of course, that the Lake City Bank had not, during the transit period, forwarded payment for said checks in cash or by draft or in some other manner.* In this connection, the pertinent portion of said Circular No. 143 is as follows:

> "Checks received by us drawn on our member banks will be forwarded in cash letters direct to such banks and each member bank *will be required either to remit therefor in immediately available funds or to provide funds available to us to meet such cash letters within the agreed*

> *transit time* to and from the member bank. Therefore, the amount of any cash letter to a member bank is chargeable against *available funds* in the reserve account of such member at the *expiration of such transit time*, which date will be shown on each cash letter. The right is reserved, however, to charge a cash letter to the reserve account of a member bank at any time when in any particular case we deem it necessary to do so." (Italics inserted.) (R. 55.)

The cash letter of October 7, 1926 shows the following notation:

> "Dispatched October 7, 1926. Chargeable against *available* balance in reserve account October 11, 1926." (Italics inserted.) (R. p. 62.)

The cash letter of October 8, 1926 shows the following notation:

> "Dispatched October 8, 1926. Chargeable against *available* balance in reserve account October 12, 1926." (Italics inserted.) (R. p. 63.)

No additional funds were obtained by the Lake City Bank in the collection of these checks, collection being accomplished by bookkeeping entries charging the checks to the accounts of the respective drawer-depositors of the bank. By accepting such checks from the Reserve Bank under Circular No. 143, the Lake City Bank impliedly agreed, as to the checks in said two cash letters, that it would make payment for the same at Richmond at the expiration of the three day transit period.

IV.

Specification of Errors.

The Circuit Court of Appeals erred in holding that the acceptance by the Lake City Bank of the checks in the cash letters in question under the terms of the collection contract raised an equitable charge or lien against the reserve deposit of said bank, and in holding, in consequence thereof, that the Reserve Bank had the right to apply the reserve deposit balance of the Lake City Bank toward payment of said checks; and the Court erred further in failing to hold that the failure and suspension of the Lake City Bank fixed the status of its reserve deposit as part of its general assets, and that no charges could thereafter be made by the Reserve Bank to deplete such reserve deposit for the purpose of paying the amounts of the checks in said cash letters, thereby giving the customers and depositors of the Reserve Bank a preferred status at the expense of the general creditors of the Lake City Bank.

V.

ARGUMENT.

Summary of Argument.

The petitioner contends:

A.

That there was neither agreement of the parties, nor understanding implied from the terms of collection, to

treat the reserve deposit balance either as equitably assigned or as a specified fund pledged to the payment of the accepted checks.

B.

That the exercise of the clearing-house functions of the Reserve Bank was not based upon the faith of the reserve deposit balance, and the authority of the Reserve Bank to make charges against the reserve deposit of the Lake City Bank was revoked by the insolvency of said bank.

C.

That the principles declared by this Court in Equitable Trust Co. *v.* First National Bank of Trinidad, 275 U. S. 359, should have been held by the Circuit Court to be controlling against the position of the Reserve Bank.

POINT A.

There was neither agreement of the Parties, nor understanding implied from the terms of collection, to treat the Reserve deposit balance either as equitably assigned or as a specified fund pledged to the payment of the accepted checks.

The acceptance of the checks by the Lake City Bank, as drawee, was not followed either by express assignment of any part of the reserve balance or by setting apart a specified sum to meet their payment. There were no unusual circumstances in the transaction. No

assurance was given that the particular fund in the reserve account should be the source from which payment would be made. The cash letters under which the checks were forwarded contained merely the notation, in substance, that at the expiration of three business days from the dates, respectively, of the cash letters, the checks therein transmitted would become *"chargeable against available balance in reserve account"* (R. p. 62-63). An assent to these terms carried with it neither tender of security nor any representation other than the understanding that the drawee bank (Lake City Bank), would, at its convenience within the agreed transit time, provide funds to make the payment at the Reserve Bank.

It is said, however, that the check collection circular, prescribing the terms of collection, establishes the right to make the charge as contended by the Reserve Bank. But this circular letter plainly states that the drawee bank has *"within the agreed transit time"* the right *"either* to remit * * * *or* to provide funds available to us (the Reserve Bank) to meet such cash letters." The full provision in this connection is as follows:

> "Checks received by us drawn on our member banks will be forwarded in cash letters direct to such banks and each member bank *will be required either to remit therefor in immediately available funds or to provide funds available to us to meet such cash letters within the agreed transit time to and from the member bank. Therefore, the amount of any cash let-*

> *ter to a member bank is chargeable against available funds in the reserve account of such member at the expiration of such transit time, which date will be shown on each cash letter.* * * *" (Italics inserted.) (R. 55.)

If there is room for doubt concerning the intent of the provision, the doubt must be resolved against the Reserve Bank as the party whose language it becomes necessary to construe. Moulor *v.* Insurance Co., 111 U. S. 335; American Surety Corporation *v.* Pauly, 170 U. S. 133. All that the parties agreed either expressly or by implication was that the obligations incurred by the Lake City Bank by the acceptance of the checks should be paid by specified dates, which dates were shown in the cash letters in which the checks were sent. See National City Bank *v.* Hotchkiss, 231 U. S. 50. It was left to the drawee bank to *provide funds* for payment of the accepted checks in the manner most convenient to itself, either by special remittance for the particular purpose, or by providing through general remittances for a sufficient balance in the reserve account, available at the expiration of the transit period to the Reserve Bank, to meet such cash letters. Either method served the same end—to pay a debt which by agreement of the parties was to be paid at Richmond on a fixed day.

In National City Bank *v.* Hotchkiss, *supra*, in disposing of the contention that the course of dealing between the parties was such as to create a trust relationship, the Court said:

> "All that the parties agreed either expressly or by implication was that the debt incurred at 10 o'clock should be paid at 3 * * *(p. 57). The consent to become a general creditor for an hour, that was imported, even if not intended to have that effect, by the liberty allowed to the firm, broke the continuity and established the loan as part of the assets" (p. 58).

In Commercial National Bank *v.* Armstrong, 148 U. S. 50, one bank transmitted to another bank commercial paper for collection under an agreement by the bank receiving the items to collect at par and remit at stated intervals. It was held that the relation of debtor and creditor was created. The reason of the decision was that collections made between the days of remitting are not, under the agreement and by the custom of banking, special deposits, but the moneys thus received pass into the general funds of the bank to be used by it as other funds; and when the day for remitting comes, the remittance is to be made out of such general funds.

A like situation exists here. The owners of the checks became general creditors of the Lake City Bank when their checks were accepted and cancelled. The terms upon which the checks were handled provided for a three day transit period. The checks sent from Richmond on the afternoon of the 7th were received in Lake City on the morning of the 8th. The Lake City Bank had, therefore, two days *after* its acceptance of the checks to provide funds to meet payment. *How the funds might be provided—whether from existing*

reserve balances, prospective reserve balances, shipments of currency, drafts upon other depositories, or otherwise—was not the concern of the owners of the checks, and no right was given them to demand that the reserve balances of the drawee bank should not be drawn upon for other purposes. On the contrary, it is to be noted that Section VI of Regulation J, Series of 1924, makes collection circulars binding upon the customer banks sending checks to the Reserve Bank for collection (R. 47), and said Circular No. 143 provides:

> "This circular sets forth fully the terms and conditions under which deposits of cash items will be accepted by the Federal Reserve Bank of Richmond * * * (R. 48).
>
> * * * * * * *
>
> "Conditions under which Items will be Received.
>
> "Every bank sending checks or other cash items to the Federal Reserve Bank of Richmond, or to another Federal reserve bank direct for our account, by such act will be understood to have agreed to the terms and conditions of this circular and of Regulation J of the Federal Reserve Board" (R. p. 49).

Hence it seems clear that the customers of the Reserve Bank sending checks to it for collection were charged with notice of the aforementioned provisions in said circular, permitting the drawee bank to pay for the checks other than by appropriation of its reserve

balance. They are also charged with notice of the following provisions of Section 19 of the Federal Reserve Act (12 U. S. C. A. 464) permitting the reserve accounts of member banks to be checked against or withdrawn:

> "*The required balance carried by a member bank with a Federal reserve bank may*, under the regulations and subject to such penalties as may be prescribed by the Federal Reserve Board, *be checked against and withdrawn* by such member bank for the purpose of meeting existing liabilities; provided, however, that no bank shall at any time make new loans or shall pay any dividends unless and until the total balance required by law is fully restored" (Section 19 of the Federal Reserve Act, 12 U. S. C. A. 464). (Italics inserted.)

It is also to be noted that the customer banks assume the risk of failure and suspension of the drawee bank and agree that in such event checks for which remittance is not made may be charged back to their accounts by the Reserve Bank, said Circular No. 143 providing in that respect: that the Reserve Bank acts only as collecting agent (R. 50); that the Reserve Bank may forward the checks "direct to the bank on which they are drawn" (R. 50); that the Reserve Bank shall not be held liable for any loss resulting from "the failure of the drawee bank or any agent to remit for such checks" (R. 50); and that

> "The amount of any check for which payment in actually and finally collected funds is not re-

ceived shall be charged back to the forwarding bank, regardless of whether or not the check itself can be returned" (R. 51).

As a matter of actual practice the reserve account, in the instant case, appears to have been treated at all times as subject to be checked against and withdrawn. The ledger entries, showing the conditions of the Lake City Bank's account from September 15, 1926 until the closing of the bank (R. pgs. 64-65), show a reserve balance of constantly fluctuating and uncertain nature, checked against or withdrawn at will,—and never treated as being charged with the payment of outstanding collection items until specifically appropriated to that end. The reserve balance at the close of business on October 7th, and at the opening of business on October 8th, when the cash letter of October 7th was accepted by the Lake City Bank, was $32,196, *but no attempt was made, either by the Reserve Bank or by the Lake City Bank to treat this balance as a fund charged with the payment of said cash letter,* and charges amounting in the aggregate to over $55,000 were made by the Reserve Bank on the 8th and 9th of October against said reserve deposit, and the balance of $22,085.52 ($22,088.48 was the amount for which suit was brought) appearing in the reserve account at the close of business on the 9th, the day the Lake City Bank suspended, was still lacking $12,982.85 of being enough to meet the two cash letters outstanding.

Such recognized right on the part of the Lake City Bank to deplete at will, its reserve deposit, without

regard to accepted cash letters, is clearly inconsistent with any theory of equitable charge or lien arising against said deposit to secure payment of said cash letters.

The case of Fourth Street Bank *v.* Yardley, 165 U. S. 634, is cited in the Circuit Court's opinion as authority for the position that there was an equitable charge against the reserve balance which arose from the acceptance of the checks; the statement of the rule that was given application in that case being quoted as follows:

> "* * * yet the authorities establish that if in the transaction connected with the delivery of the check *it was the understanding and agreement of the parties* that an advance about to be made should be a charge on and be satisfied out of a specified fund, a court of equity will lend its aid to carry such agreement into effect * * *." (Italics inserted.) (R. p. 75.)

It will be noted, however, from this quotation that even the equitable relief afforded by a court of equity in the Yardley case was dependent upon the understanding and agreement of the parties that an *advance* about to be made "*should be a charge on and be satisfied out of a specified fund.*" The error of the Circuit Court in assuming that the position taken by the Reserve Bank falls within the principle announced in the Yardley case clearly appears, we think, upon exami-

nation of the circumstances stated in the opinion in the Yardley case as follows:

> (Pg. 651): "Both were banking institutions—banks of deposit. * * * *They were not correspondents the one with the other, and there was no deposit account kept by the one with the other; indeed, so far as the usual course of commercial transactions was concerned, the banks were strangers.* The application, therefore, by the Keystone Bank to the Fourth Street Bank for accommodation under these circumstances precludes the conception that the relation between the parties was purely one of a usual and customary nature. * * *
>
> "The deduction arises that, as it cannot be reasonably conceived that the loan would have been made without the reference to and assignment of the particular fund from which alone the hope of immediate payment was to be reasonably expected, *the parties must have and did intend to create a particular appropriation, charge, or lien on the property upon the faith of which they both dealt.* The transaction, therefore, was a proposition to borrow on the one hand, accompanied with the disclosure that security was necessary and tendering the security, and, on the other hand, an acceptance of such proposal and an advance made on the faith of it. * * *
>
> (Pg. 652): "The Fourth Street Bank, as stated, was under no obligation to grant the request of the Keystone Bank; it was to derive no pecuniary advantage whatever from the proposed transaction; *it was not in any sense for the convenience of the Fourth Street Bank that the contract was made, and the bank clearly contemplated an immediate reimbursement, if it deliv-*

ered the (clearing house) certificates asked for. Had the transaction been an ordinary one, * * * and not, as it was, an extraordinary transaction, we might well presuppose that it was the expectation of the Fourth Street Bank that the borrower should merely have on hand with the Tradesmen's Bank when the check was presented a sufficient amount to pay it.

"*But the Keystone Bank, in disclosing its hazardous situation and indicating the specific fund dedicated to the payment of the solicited accommodation, did not represent that it expected to further check against the Tradesmen's Bank before the check which it proposed to give might be presented. The statements made clearly implied to the contrary,* exhibiting as they did the embarrassment of the borrowing bank, arising from the need of available cash to meet its clearings, and proposing a transaction by which the Fourth Street Bank would obtain from a bank, but a few hours distant, the prompt and certain payment of its advance.

"*As stated, this was manifestly not an ordinary mercantile transaction, but one of an extraordinary character,* and when we consider the situation and conduct of the parties, the disclosures made at the time of the contract, and weigh the probabilities of the case, *it is impossible to infer otherwise than that it was intended that the particular fund in the Tradesmen's Bank should be not only the source from which payment of the check to be given should be made, but that the fund should be transferred and appropriated pro tanto for that purpose.* * * *

(Pg. 653): "As the Fourth Street Bank contracted and parted with its money on the faith of

> the representation of the Keystone Bank that there was to its credit, in the Tradesmen's Bank, *a specific sum*, and the fund which came into the hands of its voluntary assignee is the fund as to which the representations were made, the Keystone Bank and its assignee are in equity estopped from asserting, to the prejudice of the Fourth Street Bank, that the character and condition of the fund was otherwise than it was represented to be'' (165 U. S. 651-653). (Italics inserted.)

The ordinary clearance transaction in the case at bar presents none of the elements appearing in the above stated facts in the Yardley case, wherein there was (1) a proposition to borrow; (2) a disclosure that security was necessary; (3) tendering the security; (4) the acceptance of such proposal and an advance made on the faith of it; and (5) the intention that the particular fund in the Tradesmen's Bank should be not only the source from which the payment of the check should be made, but that the funds should be transferred and appropriated *pro tanto* for that purpose.

In the case at bar the controlling elements of the transaction are altogether different, viz: (1) the recognized right of the Lake City Bank to use its reserve account for general purposes during the period between the acceptance of the collection items and the expiration of the transit time, which date was shown on each letter; and, (2) the right of the Lake City Bank *either* to remit, *or* to provide funds, at its convenience, subject only to the simple unsecured agree-

ment contained in Circular No. 143, "*to meet such cash letters within the agreed transit time to and from the member bank.*" Or, adapting to this transaction the terms used in the Yardley case, the course of dealing between the banks, instead of implying a representation that the Lake City Bank did *not* expect to further check against its deposit balance, made clearly to the contrary; and,—the transaction being an ordinary one —we might well presuppose that it was the expectation of the owners of the collected checks that the Lake City Bank should merely have on hand with the Reserve Bank, when the remittance became due, a sufficient amount to pay it.

Under such rights permitted to the Lake City Bank in respect to its reserve account, substantial balances may exist today; are gone tomorrow; are restored; the cash letters are paid; and the bank carries on. Or, on the other hand, the substantial balance which exists when the checks are dispatched for collection, and even when the checks are accepted, may be drawn out in a day's business; and, from the standpoint of security to the owner of the collection items, the intangible substance of the evanescent balance may have faded into nothingness when the bank fails.

The Principles Governing Equitable Assignments and Equitable Liens.

An agreement to remit for collection items, even where the remittance is to be made by a draft or a charge against a particular deposit account, does not constitute an assignment or create an equitable charge

against the deposit. **Christmas** *v.* **Russell**, 14 Wall. 69.

An agreement to pay out of a particular fund, however clear its terms, is not an equitable assignment, *if the assignor retains any control over the fund.* "The transfer must be of such a character that the fundholder can safely pay, and is compellable to do so. * * * Where the transfer is of the character described, *the fundholder is bound from the time of notice.*" Christmas *v.* Russel, 14 Wall. 69, 84; Meyer *v.* Delaware R. Constr. Co., 100 U. S. 457.

The duty of fundholders after notice is declared by Lord Ellenborough, in Williams *v.* Everett, 14 East, 582, cited in Tiernan *v.* Jackson, 5 Pet. 580, 600, that "they cannot retract the consent they may have once given; but are bound to hold it for the use of the appointee."

In **Smedley** *v.* **Speckman** (C. C. A. 3rd Circuit) 157 Fed. 815, 819, the absolute appropriation by the assignee of the funds sought to be assigned, and the surrender by the assignor of all control over the funds, are regarded as the requisites of a valid assignment. The opinion continues: "A mere promise, though of the clearest and most solemn kind, to pay a debt out of a particular fund, is not an assignment of the fund, even in equity. *To make an equitable assignment, there should be such an actual or constructive appropriation of the subject matter as to confer a complete and present right in the party meant to be provided for,* even where the circumstances do not admit of its immediate exercise. *If the holder of the fund retain*

control over it, it is fatal to the claim of the assignee." (Italics inserted.)

The principles governing the right of equitable lien likewise impose a duty on the part of the fundholder to devote the pledged fund to the purpose intended. A bank receiving deposits to apply for a particular purpose is bound, because of the trust, to apply such funds for the purpose specified, and for no other purpose. In stating and giving application to this rule, in the Interborough Consolidated Corporation case, 288 Fed. 334 (certiorari denied, Porges *v.* Sheffield, 262 U. S. 752), it is said:

> "*A particular fund is not 'charged' unless it is bound for the performance of an obligation imposed.*" (Italics inserted.) (Pg. 349.)

The application of the same principle is found in Woodhouse *v.* Crandall, 197 Ill. 104, 109, where it is said:

> "The banking firm assumed the position of a trustee and the money deposited constituted a trust fund, which *the bank was bound to keep intact for the purpose of the trust.*"

In Pomeroy's Equity Jurisprudence (4th ed.) section 1255, a statement of the conditions under which equitable liens or charges may be created is made as follows:

> "In order, however, that a lien may arise in pursuance of this doctrine, the agreement must deal with some particular property, either by identifying it, or by so describing it that it can

> be identified, *and must indicate with sufficient clearness and intent that the property so described, or rendered capable of identification, is to be held, given or transferred as security for the obligation.*"

So, in the case of United States *v.* Butterworth-Judson Corp., 267 U. S. 387, an equitable charge was held to be established by the deposit of money "in *special* accounts in banks, *separate* from its other funds," to be drawn upon only for specific purposes. The basis of decision is stated in the opinion of Mr. Justice Butler as follows:

> (Pg. 393): "*The agreements made the balances in the special accounts security for the obligations* of the contractor, and so created an equitable lien. (Pg. 394): * * * The purpose and effect of the special accounts was * * * *to limit the use of the fund to the purposes specified,* and so to make it available as security." (Italics inserted.)

Comments Upon Certain Cases Cited by the Court Below.

Certain cases are cited by the Circuit Court of Appeals in its opinion in support of its position (R. p. 76) and require some discussion at this point:

> *Federal Reserve Bank of Minneapolis vs. First National Bank of Eureka, 277 Fed. 300:*

In this case the Reserve Bank sued the Receiver of the insolvent bank to establish claims based upon (a)

the endorsement liability of the insolvent bank upon certain notes rediscounted with the Reserve Bank; (b) the amount of certain checks transmitted by the Reserve Bank to the insolvent bank in a cash letter for collection, which the insolvent bank had collected, and for which it had issued, in remittance, its draft to the Reserve Bank drawn upon a correspondent bank, said draft, however, not being paid before suspension of the insolvent bank. The Reserve Bank sought to apply toward payment of these obligations the deposit balance of the insolvent bank, and also the surrender value of the shares of stock owned by the insolvent bank in the Reserve Bank. The Federal District Court held that both the deposit balance, and the surrender value of the stock, should be applied toward payment of the entire indebtedness, including the amounts due under the cash letter represented by the remittance draft.

The case is, upon the surface, similar to the instant case, but there are distinguishing elements which make it clearly inapplicable as authority in support of the decision of the Court below. In the Minneapolis case immediate credit was given by the Reserve Bank to its customers who had forwarded the checks for collection, *and the Court held that the amount of said cash letter constituted a claim in favor of the Reserve Bank in its own right*, basing this in part upon a former regulation of the Reserve Board that member banks would be required to provide funds at par to cover all

checks received from Reserve Banks, and also upon the ground that the right of charge back could not be exercised by the Reserve Bank except in cases where the checks forwarded to the drawee bank were returned to the Reserve Bank, and that as to checks not so returned, and therefore not subject to charge back, the Reserve Bank was liable to its customers. In the instant case credit was *not* given to the Reserve Bank (R. p. 16); the drawee bank was *not* required, under Circular No. 143, to *keep* funds in its reserve account to meet cash letters, but had the option of *otherwise providing funds at the expiration of the transit period*, and finally the Reserve Bank has an absolute right in the instant case, to charge back the items regardless of the failure of the Lake City Bank and regardless of the return of the items to the Reserve Bank (Circular No. 143, numbered paragraphs 3, 4 and 6, pages 50 and 51 of Record). It is also to be noted that the Court below specifically held that the liability of the insolvent bank in the instant case is not due to the Reserve Bank, inasmuch as the Reserve Bank is only an agent for collection, but is due to the customers of the Reserve Bank, and that consequently there is no right of set off in favor of the Reserve Bank (R. pgs. 76-77), whereas in the Minneapolis case the Court held the insolvent bank to be indebted to the Reserve Bank and that consequently the right of set-off did exist.

Keyes, Receiver of First National Bank of Clarkfield, vs. Federal Reserve Bank of Minneapolis (an unreported decision of the United States District Court, District of Minneapolis, and to be printed by respondent as an appendix to his brief):

In this case the Reserve Bank had transmitted, as collection agent, items to the Clarkfield Bank, and before remittance had been made the Clarkfield Bank suspended. The Court stated that the sole question for decision was whether or not the Reserve Bank had the right to set off the deposit balance of the insolvent bank against the amount of the unpaid items collected by the Clarkfield Bank, and held that such right of set off did exist and that the Reserve Bank had a right of action against the insolvent bank "*in its own name and in its own right.*" The checks are treated in the opinion as having been endorsed without restriction and with credit on that day given to the bank depositing the same. The further comment is made by the Court: "The plaintiff has no standing to inquire into the relations between the defendant and its depositing banks. Neither the insolvent nor its Receiver has any concern with the question of ownership of the checks."

It being clear in the instant case that the Reserve Bank did not have a right of action in its own name, and did not have a right of set off, it would seem that the Keyes case has no application, for the reasons hereinbefore stated.

Storing vs. First National Bank, 28 Fed. (2) 587:

It seems to have been assumed (without any particular consideration of the point) that the items in question were owned by the forwarding bank in its own right, and that, as soon as the collections were made, the collecting bank became the debtor of the bank transmitting the items for collection. Upon the basis of this assumption the right of offset was held to exist. The premise governs the conclusion; and manifestly the conclusion has no application in the present case where the premise is the exact opposite.

Midland National Bank & Trust Company vs. First State Bank of Sioux Falls, 222 N. W. ~~217~~ 274, 275:

The position was taken that the forwarding bank "had the legal title, so to speak, to the dishonored drafts." The same criticism as that made of the Storing case applies. The decision in the Midland case seems also to be substantially influenced, if not wholly controlled, by the viewpoint that the claim involved only the amount by which the assets of the insolvent bank "were enhanced through the collections made immediately prior to its suspension." This also presents an obvious point of difference from the present case, where the checks were all drawn on the insolvent bank and were collected by charging them to the accounts of depositors of that bank, resulting only in a shifting of credits rather than in an augmentation of

assets. Larabee Mills *v.* First Nat'l Bank, 13 Fed. (2) 330; American Can Co. *v.* Williams, 178 Fed. 420.

POINT B.

The exercise of the Clearing-house functions of the Reserve Bank was not based on the faith of the Reserve Balance of the Member Bank.

The Federal Reserve Act originated in the need of stabilizing financial conditions. The requirement of reserve balances was designed *primarily* to provide available funds for the Federal reserve banks to take care of the financial needs of their member banks; the existence of which depended on the resources available to them and on the protection afforded to their depositors. To give this protection was the main—because the most vital—object of the banking provisions. Reserves were necessary to safe banking. *Each member bank was required to contribute its proportionate part to the strength of the financial system.*

Under the terms of Section 16 of the Federal Reserve Act the exercise of clearing house functions was permissive but not mandatory (12 U. S. C. A. 248 (*m*)). This was seemingly considered a minor part of the reserve system activities. There is no indication from any of the provisions of the Act that clearing house functions of the system were even remotely in mind so far as the statutory provision for reserve balances was concerned.

The discussion under the preceding point has indicated, with reference to the nature of the reserve de-

posit: That the deposit may be checked against and completely withdrawn, and that the amount of available balance at the expiration of the transit period is necessarily dependent upon the extent of withdrawals and deposits *after* the acceptance by the drawee bank of the checks; that the deposit is not a special account, and that no funds are set apart, to be kept separate from other funds, for the purpose of providing security for the handling of collection items; that the balance in the deposit is not required to be maintained at an amount sufficient to cover outstanding cash letters; that neither the amount of the reserve deposit, nor the probable extent of withdrawals, nor the particulars of the balance at any given time, are known to the customers of the reserve bank forwarding items to the reserve bank for collection; that the checks may be sent direct to the drawee bank, and that the only obligation of the drawee bank is to provide funds at the expiration of the transit time; that the customers of the reserve bank forwarding items for collection assume the risk of failure of the drawee bank, and that items for which remittance of payment have not been made by the drawee bank may be charged back to the account of said customers.

In view of the foregoing it seems clear that the customers of the Reserve Bank do not send items to the reserve bank on the faith of the reserve balance of the drawee bank and that they rely entirely upon the unsecured obligation of the drawee bank to provide available funds at the expiration of the transit period.

Set-off.

It is not understood that the Reserve Bank now contends that a right to apply the deposit account toward payment of these cash letters by way of set off exists, but in the interest of completeness of discussion, the point is here mentioned.

The Court below considered the point in connection with the second cause of action when it denied the right of the Reserve Bank to set off the amount due from the Reserve Bank to the Lake City Bank for the cash surrender value of the reserve stock against the liability of the Lake City Bank for the amounts of the cash letters. The Circuit Court of Appeals said in that connection:

> "It is perfectly clear that the liability of the insolvent member bank for these checks is a liability owing to the owners of the checks in which the Reserve Bank is not interested except as collection agent, and is not 'a debt of the insolvent member bank to the Federal Reserve Bank' within the meaning of the statute.
>
> "Even in the absence of a statutory direction as to how the liability should be applied, a set off of checks held for collection against such a liability would not be allowed, for the reason that demands to be set off against each other must be mutual, that is they must be due to and from the same parties and in the same capacity. 14 R. C. L. 656; 24 R. C. L. 858; Morse on Banks and Banking (6th Ed.) 334; Bank of the Metropolis *v.* New England Bank, 6 Howard 212; Smith *v.* Bath L. & B. Ass'n — Me. —, 136 Atl. 284, 50

A. L. R. 526; Yardley *v.* Clothier, 51 Fed. 506" (R. pgs. 76-77).

Also see National Bank *v.* Insurance Co., 104 U. S. 54, 71; Scott *v.* Armstrong, 146 U. S. 499.

The foregoing applies with equal force to the amount owing by the Reserve Bank to the Lake City Bank on the reserve deposit, and the Reserve Bank therefore had no greater right to set off the amount it owed the Lake City Bank for the deposit than it had to set off the amount it owed for the surrender value of the stock.

The authority of the Reserve Bank to withdraw funds from the Reserve account of its member bank was revoked by the insolvency of the member bank.

Assuming that the foregoing discussion has established that an equitable lien or charge did not exist against the deposit account of the Lake City Bank in favor of the customers of the Reserve Bank, and that consequently the Reserve Bank could not, on that ground, charge the account of the Lake City Bank with the amounts of said cash letters, and assuming, further, that no right of set off existed, it follows that if the Reserve Bank had the right otherwise to charge said account, such right must be based upon an *unrevoked authority* from the Lake City Bank to the Reserve Bank to charge said account.

It is not denied, by the petitioner, that by accepting the provisions of Circular No. 143, the Lake City Bank did invest the Reserve Bank with authority to charge

its account for the payment of outstanding cash letters, such authority to be exercised, normally, at the expiration of the current transit period but also to be exercisable, at the option of the Reserve Bank, "at any time when in any particular case we (Reserve Bank) deem it necessary to do so" (R. p. 55).

It is conceded by the Reserve Bank, however, that nothing had been done toward the exercise of the authority to charge the reserve account until after it had received notice of the failure and suspension of the Lake City Bank (R. pgs. 18-19-20). Consequently, it is the position of the petitioner that the insolvency and suspension of the Lake City Bank prior to the exercise of such authority, revoked the authority, and that the Reserve Bank could not thereafter charge such account.

The general rule is thoroughly well settled that upon insolvency or bankruptcy the assets of a debtor whereever situated, belong to his creditors, and that all third persons hold said assets in trust for the creditors and have no authority to dispose of the same. A familiar illustration, which applies by analogy to the instant case, arises where a debtor issues a check before insolvency. The bank upon which the check is drawn is, by the operation of the foregoing principle, forbidden to cash the check after the insolvency has been, by appropriate action, formally established. The reason is, of course, that the insolvency or bankruptcy of the debtor revokes any authority theretofore given by the debtor to disburse or diminish his assets, and the check

is merely an order or authority issued by the debtor on his banker authorizing and directing the banker to disburse part of his funds to the holder of the check. A banking case having very close analogy to the instant case, in principle, is First National Bank of Chicago *v.* Selden, 120 Fed. 212. In that case the receiver of a national bank brought suit against another national bank to recover the amount of certain cashier's checks issued by the insolvent bank prior to suspension and paid by the drawee bank after notice of suspension. The Circuit Court of Appeals, in sustaining the right of the receiver to recover, said in part as follows:

> (Pg. 214): "In Bank *v.* Schuler, 120 U. S. 511, 7 Sup. Ct. 644, 30 L. Ed. 704, it was decided, that as between the right of general creditors in a fund received from a bank by an assignee under a general assignment for the benefit of creditors, and the payee of an outstanding check or draft, there was no such equitable assignment *pro tanto*, of the funds in the drawee's possession, as gave to such payee a priority over the general creditors. *This, unquestionably, is the law, also respecting funds in the hands of a receiver of a national bank, appointed by the Comptroller. In each case the purpose is to obtain a ratable distribution of the insolvent bank's assets.* In neither case, in the absence of an assignment more effective than the drawing of a check, will the federal law allow one set of creditors to obtain an advantage over another set." (Italics inserted.)

In Scott *v.* Armstrong, 146 U. S. 499, 507, this Court said:

> "The Fidelity National Bank was closed by order of the bank examiner June 20th, the Receiver was appointed June 27th * * * title to its assets was necessarily thereby transferred to the Receiver. National Bank *v.* Colby, 21 Wall. 609, * * *."

Also see Edison Electric Illuminating Company *vs.* Tibbetts, 241 Fed. 468.

The provision in Circular No. 143 giving the Reserve Bank the right to charge the Lake City Bank's reserve account "at any time when in any particular case we deem it necessary to do so", is on exactly the same fundamental basis as the authority to charge at the expiration of the transit period, the only difference being as to the point in time when such authority might have been executed. The Reserve Bank *could* have exercised the authority to charge at any time during the transit period *prior to suspension* of the Lake City Bank but, such authority *not* having been exercised prior to suspension, its revocation occurred just as surely, by suspension of the Lake City Bank, as the revocation of the authority to charge at the expiration of the transit period.

The position here taken is not at variance with the principles established in McDonald *v.* Chemical National Bank, 174 U. S. 610, referred to by the Court below in its opinion (R. pgs. 73-74). In the McDonald case the insolvent bank, prior to suspension, was indebted to the Chemical Bank by reason of the overdraft

of its account with the Chemical Bank. To meet that overdraft the Capital Bank sent the Chemical bank by mail, prior to suspension, certain items for collection and for credit upon the overdraft. The items were received subsequent to suspension. The Supreme Court held that the items *were the property of the Chemical Bank* when placed in the mails. It will be noted in this connection that the Chemical Bank was a creditor of the Capital Bank *in its own right,* and that the Capital Bank had, prior to suspension, actually transmitted the item for the purpose of passing title to the Chemical Bank in part payment of that indebtedness. The Court held that in point of time the delivery of the items to the United States mail was a delivery of title to the Chemical Bank and hence that delivery occurred prior to suspension and consequently was not affected by suspension. There would seem to be no analogy between that case and the instant case. The Reserve Bank was not a creditor of the Lake City Bank and the Lake City Bank had not, prior to suspension, remitted any monies or items to the Reserve Bank, except for deposit in its reserve account in usual course, nor had the Reserve Bank, prior to suspension, exercised its right to charge the reserve account of the Lake City Bank.

The Reserve Bank seems to consider that the theory of revocation of authority to charge the deposit account depends for its application upon the existence of an agency between the Lake City Bank and the Reserve Bank, and that inasmuch as the Reserve Bank was agent of its customers for the purpose of collec-

tion of the checks contained in the cash letters, and was not an agent of the Lake City Bank, the revocation theory must fail. Petitioner concurs with the Reserve Bank in the position that the Reserve Bank was not an agent of the Lake City Bank and that it was an agent of its customers for the collection of its checks. It is not essential, however, to the revocation theory that agency exist between the Reserve Bank and the Lake City Bank, any more than it can be said that every time one draws a check upon his bank he constitutes the bank his agent. The relation between a depositor and his bank is that of debtor and creditor, and the check or other order upon the bank issued by the depositor is not that of a principal to his agent, but that of a creditor authorizing and directing his debtor how, and to whom, a portion of his credit at the bank may be disbursed. Hence the lack of agency between the Lake City Bank and the Reserve Bank does not prevent the application of the revocation of authority doctrine.

Point C.

The decision of this Court in Equitable Trust Co. v. First National Bank of Trinidad, 275 U. S. 359, is authority against the position of the Reserve Bank.

The firm of Knauth, Nachod & Kuhne, hereafter called the bankrupts, were international bankers. They had credit with many foreign banks; and, to enable small banks in this country to issue drafts upon such foreign banks in their own name, offered these

terms: "Upon receipt of advice of draft, accompanied by adequate funds payable at par in New York, we shall promptly forward our advice of the same and provide the drawee with funds sufficient for the payment of the draft abroad, *by a transfer of credit from our balance, or otherwise,* provided the draft is drawn on the bank named in our latest list of correspondents" (Pg. 365). In accordance with this plan, the Trinidad Bank drew a draft on a branch of the Banca Commerciale Italiana, advised the bankrupts that they had drawn the draft, and remitted funds to the bankrupts which they received and deposited to their general account. The bankrupts sent to the Italian bank a list and description of drafts issued, including the draft issued by the Trinidad bank, with a request to "honor the above listed drafts charging same to our account." (Pg. 366.) The Italian bank debited the account of the bankrupts and made a corresponding credit at the same time in an account termed "drafts payable." The draft of the Trinidad bank *was presented after the petition in bankruptcy had been filed,* and was dishonored.

The Circuit Court of Appeals, Second Circuit, 13 Fed. (2d) 732, 735, held that an equitable charge had been created by the agreement and acts of the parties, saying:

> "Therefore it seems to us that the agreement to transfer the credit, *followed by its actual transfer,* provided a fund which the drawee was obliged to devote to the payment of the draft; that is, that it created an equitable assignment

> or an irrevocable declaration of trust by the bankrupts" (pg. 735).

A writ of certiorari was applied for and was granted by this Court. Upon the hearing of the cause, the court divided. The majority opinion, written by Mr. Justice Holmes, stated the conclusion that the transaction did not constitute the appropriation of funds for a specific use and did not show an intent to establish

> "an attenuated property right in an account to which no special funds were attached and the particulars of which neither the respondent nor the purchaser of the check could know." (Pg. 369)

The analysis of the case made by Mr. Justice Holmes shows a consideration of factors leading to this conclusion as follows: (1) the ignorance of the whole affair on the part of the holder; (2) the general understanding that the account was subject to the bankrupt's control; and (3) that

> "the terms offered by the bankrupts to their correspondents seem to us to promise the appropriation of a specified fund to the draft as little as they promise to apply the money received by them to that end. They are to provide the drawee bank with sufficient funds for the payment of the drafts by transfer of credit 'from our balance *or otherwise'. They are to provide, that is, as convenient to themselves, for payment by the drawee bank; *not to give them an earmarked corpus to be handed over.*" (Pg. 367)

In the banking transaction above reviewed, we find: (1) the agreement of the insolvent bank to provide

sufficient funds to meet payment of the items; (2) the authority to the bank in which the funds of the insolvent bank were held on general deposit, to make an appropriation of such funds for the purpose of payment; and (3) the setting apart of funds,—under such authority and in accordance with the standing agreement between the insolvent bank and the bank in which the deposit account was carried,—to a special "drafts payable" account for the purpose of meeting the items in transit.

In the case at bar,—under the provisions of Regulation J and the check collection circular issued pursuant thereto,—we find only the agreement of the insolvent bank *to provide funds,* and the authority to the Reserve Bank, in which funds of the insolvent bank were held on general deposit, to make an appropriation of available funds in the deposit account for the purpose of the payment. The sole requirement of the insolvent bank in the instant case was to provide sufficient funds to meet the payment of the checks at a later specified date, by transfer of credit from available funds in the reserve account 'or otherwise'. Its obligation was to provide these funds *in such manner as might be convenient to itself* within the three day transit period and not to furnish upon the acceptance of the check either "an earmarked corpus to be handed over" or "an attenuated property right in an account to which no special funds were attached."

In the Bank of Trinidad case the money was directly deposited with the bankrupt upon the agreement that it should be paid over to the owner through the clear-

ing bank by establishing a credit which would be subject to the drafts of the owners of the money. In the case at bar, the owners of checks drawn on the Lake City Bank deposited the checks with the Reserve bank for collection upon the agreement that, at the expiration of the transit period, and upon the proceeds of the *collections being received*, the credit thereby established at the Reserve bank would be subject to the drafts of the owners of the money.

The theory of a distinction between the two cases, as held by the Circuit Court of Appeals, seems somewhat difficult to follow in considering the application of the principles involved in the Bank of Trinidad opinion.

The division of opinion in the Bank of Trinidad case arose because of circumstances which were believed in the minority opinion to show the complete performance of the bankrupt's agreement to provide funds, by setting apart in a special "drafts payable" account enough of its credit with the clearing bank to meet the payment of the items in transit. This feature of the Bank of Trinidad case, which was the basis of decision in the Circuit Court and also the basis of the minority opinion in this Court, is altogether lacking in the case now presented; and the agreement to provide funds stands by itself without anything having been done to carry the agreement into effect until after the act of insolvency had occurred.

The soundness of decision in the case of Eastman Kodak Co. *v.* National Park Bank, 231 Fed. 320, affirmed 247 Fed. 1002, is recognized in the majority

opinion of this Court in the Bank of Trinidad case. It had likewise been recognized, although refused application, in the Circuit Court opinion, 13 F. (2d) 732, 735, where the Court commented on the Eastman Kodak Co. case that "the drawee had not transferred the credits, and, so far as appeared, remained free to pay the drafts in the order of their presentation." The opinion then continued:

> "Mere notice by the drawer does not establish a priority upon the fund in favor of the drafts advised. It is a vital difference when the drawee by specific credits provides for specific drafts. These must then be paid, no matter how many others come in before them, and that implies a final appropriation *pro tanto.*"

Were specific credits provided to meet the specific payments? This was the question of the Bank of Trinidad case, and the majority opinion held that the specific credits had not been provided. This is also the question of the case at bar. The Circuit Court opinion in the instant case has answered the question by saying that "the rights of the owners of the checks to have same charged against the reserve account of the drawee bank arose and became fixed when the bank accepted them" (R. pg. 74). But if this was the result of the acceptance of the checks, there must also have been the corollary result that these charges "must then be paid, no matter how many others come in before them and that implies a final appropriation *pro tanto.*" (13 Fed. (2) 735.) The facts of the transaction deny the theory of the opinion. The cash letter for $14,-

900.62, forwarded on October 7, was accepted by the Lake City Bank on October 8. The reserve balance on the morning of that day was $32,196. This was used to pay other liabilities of the Lake City Bank, the charges against the deposit account of the 8th being $33,565. The balance was partly restored during the day by deposits amounting to $28,150. The cash letter of the 8th for $20,170.71 was accepted by the Lake City Bank on October 9. The balance on the morning of the 9th was $26,781; charges $21,848; credits $17,153. The funds remaining in the reserve balance at the close of business on the 9th were of the same general character as the funds that had been freely paid out of the reserve account on the 8th and 9th, after checks contained in the cash letters had been accepted.

It was contemplated that *available* funds existing in the reserve account on the morning of the 11th should be applied, if settlement had not otherwise been made, to the payment of the cash letter of the 7th; and likewise, *available* funds on the 12th to the payment of the cash letter of the 8th. It was equally within the contemplation of all the parties to the transactions that the reserve balances of the 8th and 9th—as they existed when the cash letters were accepted—could be drawn upon and paid out for other purposes. *The funds in the reserve balance, which were thus treated as general assets of the bank up to the time it closed, must still be treated as general assets;* and, as such, *not* available to apply to the payment of the outstanding cash letters.

Conclusion.

(1) *The Equities Lie with the Receiver.*

The Receiver represents the general creditors of the insolvent bank. Section 5234, U. S. R. S. (12 U. S. C. A. 192), ~~provides~~ contemplates that the administration of the assets shall be by the Receiver for the benefit of the general creditors, and Section 5236, U. S. R. S. (12 U. S. C. A. 194), provides that from time to time a "ratable dividend" shall be made to such general creditors. First National Bank of Chicago *vs.* Selden, 120 Fed. 212; Scott *vs.* Armstrong, 146 U. S. 499, 506.

The funds in suit are assets of the insolvent bank. The distribution of such assets by the Reserve Bank, by appropriating them to the payment of the depositors of the Reserve Bank, instead of permitting them to be distributed by the Receiver for the benefit of all of the creditors, would be contrary to the statute, and would give such depositors of the Reserve Bank an unauthorized preference. Such depositors are creditors, not of the Reserve Bank, but of the insolvent bank, and should make their application to, and obtain their redress from, the Receiver.

(2) *The Deposit Should be Ordered Returned to the Receiver for the Benefit of the General Creditors.*

No right to an equitable charge, or to a set off, against the deposit, having been established, and the

authority of the Reserve Bank to charge the account having been revoked by notice of suspension, the deposit constitutes assets of the Receiver and should be ordered returned to him for the benefit of the general creditors including as such the owners of the items contained in the cash letters.

Respectfully submitted,

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Of Counsel.

APPENDIX A.

Provisions of Federal Reserve Act.

(1)

The Federal Reserve Board shall make and promulgate from time to time regulations governing the transfer of funds and charges therefor among Federal reserve banks and their branches, and may at its discretion exercise the functions of a clearing house for such Federal reserve banks to exercise such functions, and may also require each such bank to exercise the functions of a clearing house for its member banks (Section 16 of the Federal Reserve Act, 12 U. S. C. A. 248 (*m*)).

(2)

The required balance carried by a member bank with a Federal reserve bank may, under the regulations and subject to such penalties as may be prescribed by the Federal Reserve Board, be checked against and withdrawn by such member bank for the purpose of meeting existing liabilities; provided, however, that no bank shall at any time make new loans or shall pay any dividends unless and until the total balance required by law is fully restored (Section 19 of the Federal Reserve Act, 12 U. S. C. A. 464).

APPENDIX B.

Regulation J, Series of 1924.

(Superseding Regulation J of 1920.)

Check Clearing and Collection.

SECTION I. Statutory Provisions.

Section 16 of the Federal Reserve Act authorizes the Federal Reserve Board to require each Federal reserve bank to exercise the function of a clearing house for its member banks, and section 13 of the Federal Reserve Act, as amended by the act approved June 21, 1917, authorizes each Federal reserve bank to receive from any nonmember bank or trust company, solely for the purpose of exchange or of collection, deposits of current funds in lawful money, national bank notes, Federal reserve notes, checks and drafts payable upon presentation, or maturing notes and bills, provided such nonmember bank or trust company maintains with its Federal reserve bank a balance sufficient to offset the items in transit held for its account by the Federal reserve bank.

SECTION II. General Requirements.

In pursuance of the authority vested in it under these provisions of law, the Federal Reserve Board, desiring to afford both to the public and to the various banks of the country *a direct, expeditious, and economical system of check collection and settlement of balances,* has arranged to have each Federal reserve bank exercise the functions of a clearing house and collect checks for such of its member banks as desire

to avail themselves of its privileges and for such nonmember State banks and trust companies as may maintain with the Federal reserve bank balances sufficient to qualify them under the provisions of section 13 to *send* items to Federal reserve banks for purposes of exchange or collection. Such nonmember State banks and trust companies will hereinafter be referred to as nonmember clearing banks.

Each Federal reserve bank shall exercise the functions of a clearing house and collect checks under the general terms and conditions hereinafter set forth.

SECTION III. Checks Received for Collection.

(1) Each Federal reserve bank will receive at par from its member banks and from nonmember clearing banks in its district, checks drawn on all member and nonmember clearing banks, and checks drawn on all other nonmember banks which are collectible at par in funds acceptable to the Federal reserve bank of the district in which such nonmember banks are located.

(2) Each Federal reserve bank will receive at par from other Federal reserve banks, and from all member and nonmember clearing banks in other Federal reserve districts which are authorized to route direct for the credit of their respective Federal reserve banks, checks drawn on all member and nonmember clearing banks of its district, and checks drawn on all other nonmember banks of its district which are collectible at par in funds acceptable to the collecting Federal reserve bank.

(3) No Federal reserve bank shall receive on deposit or for collection any check drawn on any nonmember bank which can not be collected at par in funds acceptable to the Federal reserve bank of the district in which such nonmember bank is located.

SECTION IV. Time Schedule and Availability of Credits.

(1) Each Federal reserve bank will publish a time schedule showing the time at which any item sent to it will be counted as reserve and become available for withdrawal or other use by the sending bank. For all checks received, the sending bank will be given immediate credit, or deferred credit, in accordance with such time schedule, and as provided below.

(2) For all such checks as are received for immediate credit in accordance with such time schedule, immediate credit, subject to final payment, will be given upon the books of the Federal reserve bank at full face value in the reserve account or clearing account upon day of receipt, and the proceeds will at once be counted as reserve and become available for withdrawal or other use by the sending bank.

(3) For all such checks as are received for deferred credit in accordance with such time schedule, *deferred credit, subject to final payment,* will be entered upon the books of the Federal reserve bank at full face value, but the proceeds will not be counted as reserve nor become available for withdrawal or other use by the sending bank *until such time as may be specified in such time schedule,* at which time credit will be transferred from the deferred account to the reserve account or clearing account subject to final payment and will then be counted as reserve and become available for withdrawal or other use by the sending bank.

SECTION V. Terms of Collection.

The Federal Reserve Board hereby authorizes the Federal reserve banks to handle such checks subject

to the following terms and conditions; and each member and nonmember clearing bank which *sends* checks to any Federal reserve bank for deposit or collection shall by such action be deemed (*a*) to authorize the Federal reserve banks to handle such checks subject to the following terms and conditions, (*b*) to warrant its own authority to give the Federal reserve banks such authority, and (*c*) to agree to indemnify any Federal reserve bank for any loss resulting from the failure of such sending bank to have such authority.

(1) A Federal reserve bank *will act only as agent* of the bank from which it receives such checks *and will assume no liability except for its own negligence* and its guaranty of prior indorsements.

(2) A Federal reserve bank may present such checks for payment or *send such checks for collection direct to the bank on which they are drawn* or at which they are payable, or in its discretion may forward them to another agent with authority to present them for payment or send them for collection direct to the bank on which they are drawn or at which they are payable.

(3) A Federal reserve bank may in its discretion and at its option, either directly or through an agent, *accept either cash or bank drafts in payment of or in remittance for such checks and shall not be held liable* for any loss resulting from the acceptance of bank drafts in lieu of cash, nor *for the failure of the drawee bank or any agent to remit for such checks,* nor for the nonpayment of any bank draft accepted in payment or as a remittance from the drawee bank or any agent.

(4) Checks received by a Federal reserve bank on its member or nonmember clearing banks will ordinarily be forwarded or presented direct to such banks, and such banks will be required *to remit or pay there-*

for at par in cash or bank draft acceptable to the collecting Federal reserve bank, *or* at the option of such Federal reserve bank *to authorize such Federal reserve bank to charge their reserve accounts or clearing accounts;* provided, however, that any Federal reserve bank may reserve the right in its check collection circular to charge such items to the reserve account or clearing account of any such bank at any time when in any particular case the Federal reserve bank deems it necesary to do so.

(5) Checks received by a Federal reserve bank payable in other districts will be forwarded for collection upon the terms and conditions herein provided to the Federal reserve bank of the district in which such checks are payable.

(6) The amount of any check for which payment in actually and finally collected funds is not received *shall be charged back to the forwarding bank,* regardless of whether or not the check itself can be returned.

SECTION VI. Other Rules and Regulations.

Each Federal reserve bank shall also promulgate rules and regulations not inconsistent with the terms of the law or of this regulation, governing the details of its check clearing and collection operations. Such rules and regulations shall be set forth by the Federal reserve banks in their letters of instruction to their member or nonmember clearing banks and shall be binding upon any member or nonmember clearing bank which *sends* any check to such Federal reserve bank for collection or to any other Federal reserve bank for the account of such Federal reserve bank for collection.

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SUPREME COURT of the UNITED STATES

OCTOBER TERM, 1929

No. 226

THOMAS A. EARLY, Receiver of the Farmers & Merchants National Bank of Lake City, Petitioner,

v.

FEDERAL RESERVE BANK OF RICHMOND,
Respondent

BRIEF IN OPPOSITION TO WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE FOURTH CIRCUIT.

M. G. WALLACE,
Counsel for Respondent,
Richmond, Va.

(34,357)

THE WILLIAM BYRD PRESS, INC., RICHMOND, VA.

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SUPREME COURT of the UNITED STATES

OCTOBER TERM, 1929

No. 226

THOMAS A. EARLY, RECEIVER OF THE FARMERS & MERCHANTS NATIONAL BANK OF LAKE CITY, PETITIONER,

v.

FEDERAL RESERVE BANK OF RICHMOND,
RESPONDENT

BRIEF IN OPPOSITION TO ALLOWANCE OF WRIT OF CERTIORARI

FOREWORD

The essential facts in this case are accurately, although briefly, stated in the petition for certiorari. We refer to the agreed statement of facts (Record pages 15-21) and the opinion of the Circuit Court of Appeals (Record pages 68-77) for a more comprehensive statement of the details of the transaction involved.

On pages 17-19 of the petition and brief appears an argument showing that the petition for certiorari is filed at a proper stage of the proceedings. The case was submitted upon an agreed statement of facts; therefore, only questions of law were involved. The decision of the Circuit Court of Appeals disposed of all such questions completely, and is therefore in substance a determination of the controversy, although not in form a final judgment. While we contend that the questions involved are not such as are usually reviewed by certiorari, we concede that the petition was filed at a proper time, and join with petitioner in respectfully requesting the court to consider the questions presented as if the decision of the Circuit Court of Appeals had been in substance as well as form a final judgment.

I

Grounds for Opposition

The reasons given for the granting of the petition are (Petition page 7):

First, that the case presents an important question of banking law arising under the Federal Reserve Act and involving the construction of regulations issued by the Federal Reserve Board under the authority of said Act, which has been decided by the Circuit Court of Appeals in a way probably untenable and probably in conflict with the applicable decisions of this court.

Our answer to this is that the case involved is the construction of a contract made by a Federal Reserve bank in pursuance of general authority granted by the Federal Reserve Act, and in pursuance of express permission contained in the Regulations of the Federal Reserve Board. There is no suggestion that the contract was ultra vires or void, and the decision below was rested entirely upon the construction and application of the contract.

Every decision construing a contract is dependent upon the terms of the particular contract under consideration, and citation of cases construing other contracts of the same general nature are seldom conclusive. We have found no decision of this court which appears to deal with a similar contract, but the decision of the Circuit Court of Appeals was in accord with prior decisions of state and other federal courts construing similar contracts. (See *Federal Reserve Bank* v. *First National Bank* (U. S. D. C.), 277 Fed. 300; *Storing* v. *First National Bank* (C. C. A. 8th), 28 Fed. (2nd) 587; *Midland National Bank and Trust Company* v. *First State Bank of Sioux Falls, Minn.*, Nov. 30, 1928, 222 N. W. 274; and *Farmers National Bank* v. *Penn Bank,* 123 Pa. 283, 16 Atl. 761), affirmed without opinion; *Penn Bank* v. *Farmers National Bank,* 130 Pa. State 209, 20 Atl. 150.

The second ground upon which review by certiorari is asked is that the decision of the Circuit Court of Appeals has probably allowed a preference in favor of the holders of checks presented by a Federal Reserve bank in the liquidation of a National bank. The question presented by the record was whether or not a sum of money was at the time of the failure due to the failing bank or whether it had before suspension been definitely appropriated by the act of the failed bank for the payment of checks presented to it. The principle of equality of distribution among creditors of a failed bank was involved only in the general sense that such principle is involved in all suits by the receiver of a National bank to recover claims said to be due to that bank.

The third ground upon which review by certiorari is asked appears to be substantially the same as the first; that is to say, that the case involves an important question of banking law of a Federal nature which has not been but should be settled by this court. As we have said above, the decision was rested upon the construction of a contract such as any bank might lawfully make with its customers. Federal Reserve banks are generally authorized to make con-

tracts and the Regulations of the Federal Reserve Board expressly permit each Federal Reserve bank to issue circulars governing the details of its check clearing and collection operation (Record page 47). There is no suggestion in the record that the precise method employed by the Federal Reserve Bank of Richmond as defined in the circular which it issued is identical with arrangements made by any other Federal Reserve bank.

We therefore submit that this case presents no question of sufficient general importance to require review by certiorari, and furthermore the decision of the Circuit Court of Appeals in construing and applying the contract between the parties is so plainly right that review by certiorari can serve only to prolong unnecessarily the litigation.

Answer to Petitioner's Point A

(Petitioner's Brief pages 25-30)

Federal Reserve Bank of Richmond's Circular No. 143 (Exhibit No. 2, page 47) is a complete statement of the terms and conditions upon which the Federal Reserve Bank of Richmond undertook to handle checks deposited with it. A copy of the circular was sent to every member bank concerned and accepted by it (Exhibit No. 4, Record page 61, and Paragraphs 7 and 9, Record page 17). The circular therefore was a complete contract defining the rights of the three parties concerned in the collection of each check, i. e., the depositing bank, which was entitled to receive payment; the drawee bank, which was bound to make payment; and the Federal Reserve Bank, which, as agent for its depositor, undertook to collect the check in the manner specified in the circular. The provision of the circular which is essential to the determination of this case is as follows (Record page 55):

> "Checks received by us drawn on our member banks will be forwarded in cash letters direct to such banks and each member bank will be required either to remit

> therefor in immediately available funds or to provide funds available to us to meet such cash letters within the agreed transit time to and from the member bank. Therefore, the amount of any cash letter to a member bank is chargeable against available funds in the reserve account of such member at the expiration of such transit time, which date will be shown on each cash letter. *The right is reserved, however, to charge a cash letter to the reserve account of a member bank at any time when in any particular case we deem it necessary to do so.*"

We italicize the last sentence because in the discussion of this point in the brief for the petitioner the last sentence is omitted in the quotation and ignored in argument, and it was upon this clause that the decision of the Circuit Court of Appeals was in a large measure rested. (See opinion of Parker, Judge, Record pages 69-73.) A comparison of petitioner's Point A, as it is stated in his brief, with the plain and positive language of the contract, appears of itself sufficient to refute the petitioner's proposition.

The petitioner's proposition is:

> "There was neither agreement of the parties nor understanding implied from the terms of collection to create an equitable lien or charge on the Reserve Balance as security for the payment of checks."

The language of the contract is:

> "The amount of any cash letter to a member bank is chargeable against available funds in the reserve account of such member bank at the expiration of such transit time, which date will be shown on each cash letter. The right is reserved, however, to charge a cash letter to the reserve account of a member bank at any time when in a particular case we deem it necessary to do so."

The first principle of the law of contracts is that as a man consents so is he bound. Reference to the situation

of the parties and to their probable objects is unnecessary when the contract between them is clear and unambiguous; but a consideration of the situation of the parties in this case will, we believe, make the intention of the parties more obvious.

The holder of a check is by law required to present it to the drawee bank and demand payment in cash. When a check is received by one who is at a distance from the bank upon which the check is drawn, presentation in person or by special agent is impracticable. The holder is therefore usually compelled to employ banks as agencies to make collection through banking channels. Thus, in the course of business each day the ordinary commercial bank receives on deposit or for collection checks drawn upon other banks in many widely separated places. It would not be economical for any commercial bank to maintain direct correspondence with an agent in every place in which a check might be payable, as this would entail the selection of a correspondent in each city, town, and village in the country, so commercial banks ordinarily forward checks to selected correspondents who will undertake to collect all checks payable in a specified area. Settlement with such correspondents for checks collected is effected either by remittance of the proceeds or by setting off liabilities for checks collected for such correspondents against demands for the proceeds of checks collected by them. The routing of any check may involve handling by several banks. A small California bank may deposit almost all checks received by it with a San Francisco correspondent. If one of these checks be payable in Virginia, the San Francisco bank, which probably has no correspondent in Virginia, may send the check to a correspondent in Chicago or New York, which will probably send it to a bank in Richmond, which latter bank probably undertakes to collect for its correspondents all checks payable in Virginia. The city bank which receives a check on banks in a certain area, eg., a Richmond bank, undertaking to collect all checks in Virginia, must

devise means for dealing with agents at each banking point in its territory. Two methods may be used: A check may be sent for payment direct to the bank upon which it is drawn, or it may be sent to another bank in the same place to collect from the drawee by presentation. In other words, the drawee may be the agent to collect from itself, or another bank may be used as agent to collect from it. Both methods have advantages and disadvantages. The former is the most expeditious, but places the drawee in a position where it represents conflicting interest, and so if it be in a weakened condition, is tempted to cancel the checks sent to it and so release the drawers, although it is unable to pay the amount to the forwarding bank, rather than return the check and confess its inability to meet the demands upon it. The latter system may be somewhat more safe, but it also involves the risk of loss from failure of the collecting bank.

When a check has been paid by the drawee, two methods of settlement with the forwarding bank are possible. The drawee, or other collecting bank, may remit the proceeds by a draft acceptable to its correspondent or by other methods of remitting money, or if the collecting or paying bank has a balance to its credit with the forwarding bank, this balance may be charged in accordance with arrangements previously made. The latter method is possible only when the collecting or paying bank has a regular account with the forwarding bank; but, when it is possible, it is obviously in many respects a simpler and safer method of dealing. The first method is called the "remittance" method and the second the "charge and credit" method.

The Federal courts and many State courts hold that the initial bank is in the absence of clear and positive agreement responsible for all the sub-agents through which the checks are routed (See *City of Douglas* v. *Federal Reserve Bank,* 271 U. S. 489, 46 Sup. Ct. 554, 70 L. Ed. 1051, and *First National Bank* v. *Federal Reserve Bank* (C. C. A. 8th), 6 Fed. (2nd) 339). Since banks receive only an incidental compensation for collecting checks, they naturally

seek to restrict or limit their liability for losses which they cannot avoid; but, since every such loss falling on the depositor tends to weaken his confidence in his bank, forwarding banks naturally and properly attempt to devise methods of dealing which will reduce such losses to a minimum, and when depositors assume the risk of such losses, they are naturally much interested in precautions which will be taken to avoid such losses and the methods which will be used in dealing with sub-agents.

Prior to the inauguration of the Federal Reserve System, banks were dependent upon such arrangements as they could make with correspondents. It was evident, however, when the Federal Reserve banks were established, that if each Federal Reserve bank could collect all checks within it's district by direct dealings with the bank upon which the check was drawn, or through some other bank in the same place, and could collect all checks not payable in their own districts through the Federal Reserve bank of the proper district, then a regulated and orderly system for the collection of checks could be established in place of the somewhat irregular system which had been in use; but under the new system the Federal Reserve bank would merely perform functions of the same nature as those previously performed by city banks collecting checks for depositors.

Under the Federal Reserve Act Federal Reserve banks were required to receive on deposit checks upon solvent member banks (Federal Reserve Act 16, 38 Stat. 265, 12 U. S. C. 360) and authorized to receive for collection checks upon any bank in their districts (Federal Reserve Act 13, 40 Stat. 234, 12 U. S. C. 342). When Federal Reserve banks were authorized as above to receive checks on non-member banks, such banks were under certain conditions allowed to open clearing accounts with Federal Reserve banks and deposit checks with Federal Reserve banks for collection. Such non-member banks are in the position of member banks so far as the clearing and collecting of checks is concerned. If a non-member bank does not desire to open a clearing

account, but is willing to remit at par for checks sent it by the Federal Reserve bank, the Federal Reserve bank can make an arrangement with it whereby the non-member bank will remit in a satisfactory way for checks upon itself.

The difficulties which may prevent the handling of checks upon non-member banks were elaborately discussed by this court in *Farmers and Merchants Bank of Monroe, et als,* v. *Federal Reserve Bank of Richmond,* 262 U. S. 649, 43 Sup. Ct. 651, 67 L. Ed. 825, and likewise in *American Bank and Trust Company, et als,* v. *Federal Reserve Bank,* 256 U. S. 350, 41 Sup. Ct. 499, 65 L. Ed. 983, and same case 262 U. S. 643, 43 Sup. Ct. 649, 67 L. Ed. 1153.

In this case we are concerned only with dealings with a member bank and we have digressed to describe the relationship of the other two classes; that is to say, non-member clearing banks which have clearing accounts, and non-member remitting banks, only in order that the distinction in the use of these terms in the Regulation of the Federal Reserve Board may be apparent.

In collecting checks drawn upon non-member remitting banks it is obvious that only the "remittance" method can be used, but in collecting checks drawn upon member banks and clearing non-member banks either the "remittance" method or the "charge and credit" method may be used. Federal Reserve Board therefore authorized each Federal Reserve bank to select the method deemed most convenient in dealing with the latter classes (Regulation J, V. 4, Record page 46). The Federal Reserve Bank of Richmond adopted the "charge and credit" method (Circular No. 143, Paragraph headed "Our Cash Letters to Member Banks," Record page 55).

The circular made a complete statement of the method which would be used and expressly provided that checks sent to a member bank were, unless returned, absolutely chargeable to its reserve account, the actual entries being made in accordance with a schedule determined by the time necessary for a letter to reach the member bank and return

checks or an acknowledgment to reach Richmond. In the case at bar the Lake City bank acted under this contract, cancelled the checks, and thereby created an irrevocable liability for the amount of these checks and an irrevocable right on the part of the Federal Reserve Bank to charge them to its reserve account. The actual entry was deferred merely as a matter of accounting convenience. The right became irrevocable when the checks were cancelled.

If the provisions of the circular construed in the light of the situation do not mean that the reserve balance is to be applied upon all checks cancelled by the Lake City bank and not returned, we are unable to see that any force or effect may be given to the provisions of the circular which we quoted; and, of course, it is an elementary rule of construction that every provision of a contract was intended to have some substantial effect.

Answer to Petitioner's Point B (1)

(Petitioner's Brief pages 30-32)

The argument of petitioner in this section of his brief seems to be directed to the demonstration of the proposition that the provision in Circular No. 143, by which the reserve balance was made chargeable with the amount of the checks sent to the Lake City bank, was not essential to the successful operation of the check clearing or collection system of the Federal Reserve Bank.

We do not contend that no method of collecting checks upon member banks could be adopted other than the one adopted by the Federal Reserve Bank of Richmond, but we say that this method was the one which was duly adopted and upon the faith of which the depositing banks acted, and knowing this and consenting to this the Lake City bank acted. Furthermore, we contend that this method allows the ready use of the reserve of the member bank for its chief purpose. The object of a reserve is to enable a bank to meet withdrawals. Withdrawals are commonly made by

checks. Checks are presented in three ways: (1) By holders at the counter of the drawee bank; (2) By other banks in the same town; (3) By out-of-town banks through the mails.

Very few checks are presented in the first way. Checks presented in the second way are usually handled through a local clearing house, or are set off against checks on the presenting bank and only the net balance is paid. Perhaps the majority of all checks on a bank, especially if it be in a small town, are presented by mail. Since it is known that a Federal Reserve bank will collect a check upon any of its members in a minimum time and with no charge, the majority of all checks held by persons in other places, perhaps, in the case of banks in small towns, a majority of all checks on the bank are presented through the Federal Reserve bank. Payments for such withdrawals can be made most conveniently to the Federal Reserve bank from funds already in its hands, for in such a case a mere adjustment of the account closes the transaction.

The daily receipts of a bank are chiefly in the form of checks on other banks. Checks on all banks and many nonmember banks are collectible through Federal Reserve banks; hence a member bank can deposit with its Federal Reserve bank many checks on other banks. The proceeds of these checks when collected are credited to the reserve account of the depositing bank and will thus counteract the depletion made by payment of checks presented through the Federal Reserve banks. The withdrawals from and increments to the reserve being made through the same channel, unnecessary transfers of funds are avoided; so that the method under which a check is chargeable to the reserve account of the drawee bank if not returned is a convenient method of effecting the collection of the check, and one which affords to the holder of the check as much protection as can be afforded under practical banking conditions.

Petitioner lays stress upon the fact that the reservation

of the right to charge the reserve balance with checks accepted and cancelled by a member bank is not always a complete protection. The case at bar illustrates this, but also illustrates that it will often times afford protection. Courts of course may not refuse to enforce contracts merely because circumstances may be suggested in which the contract would not be of subtsantial value to the obligee.

Petitioner emphasizes the fact that the protection afforded to depositors in the case of checks on members banks is greater than the protection afforded in the case of checks upon non-member remitting banks. The mere fact that parties are not able to protect themselves in some transactions is of course no reason for failing to allow them the full benefit of the provisions of their contract in cases to which the provision is applicable.

Answer to Petitioner's Point B (2)

(Petitioner's Brief pages 32-34)

This point appears to depend upon the proposition that the Federal Reserve Bank was an agent of the Lake City bank to pay the checks in question. We are unable to see any element of agency in the relation of the parties. The Federal Reserve Bank was an agent of the depositing banks to collect the checks from the Lake City bank. The checks were entrusted to the latter upon the condition that they were chargeable against its reserve account unless returned. They were not returned and the question is: Did the suspension of the Lake City bank annul the condition upon which the checks were entrusted to it? This question has been so fully answered by the opinion of Judge Parker (Record page 74) that further discussion seems superfluous.

If the relation of the Federal Reserve Bank to the Lake City bank resembles an agency in any respect, it is an agency coupled with an interest, for the Federal Reserve Bank was obliged to secure payment for the checks deposited with it, if possible, and therefore had an interest

in securing such payment. Such an agency is irrevocable and is in effect an assignment (See *Hunt v. Rousmanier's Admr's,* 8 Wheat. 174).

It is elementary that the receiver in such a case can enforce such demands as the insolvent bank could have made at the moment of its suspension. If the Lake City bank had called the Federal Reserve Bank by telephone on the afternoon of Saturday, October 9, 1926, and had stated to the Federal Reserve Bank that the checks in the letters of October 7th and 8th had been cancelled and charged to the drawers and so could not be returned, but had then demanded that the Federal Reserve Bank should ship to the Lake City bank the amount of the reserve balance, leaving the checks unpaid and with no provision for their payment, would the Federal Reserve Bank have been bound to ship the money or could it have rightfully replied to this demand by saying that the balance would be held and applied on the checks, as provided in the contract between the parties? We submit that this question can be answered in one way only—that is, as the Circuit Court of Appeals answered it.

Answer to Petitioner's Point C

(Petitioner's Brief pages 35-39)

This section of petitioner's brief is confined to the proposition that the decision of the Circuit Court of Appeals is inconsistent with the principles of law enunciated by this court in *Equitable Trust Company* v. *First National Bank,* 275 U. S. 359, 48 Sup. Ct. 167 (erroneously cited in petitioner's brief as 257 U. S. 359). The Circuit Court of Appeals discussed the above decision fully and pointed out that the facts bore no analogy of the facts of the present case. A statement of the facts in that case is the best method of distinguishing it.

Knauth, Nachod and Kuhne were bankers apparently dealing in foreign exchange and had a contract with the

First National Bank of Denver whereby the latter might draw drafts on banks in foreign countries and the former would arrange for the payment of such drafts on presentation. In pursuance of the agreement First National Bank of Denver drew a check or draft on Banca Commerciale Italiana and requested Knauth, Nachod and Kuhne to protect the same. They requested Banca Commerciale Italiana to honor the draft for their account. Banca Commerciale Italiana upon receipt of the request from Knauth, Nachod and Kuhne charged the amount to their account and credited it to a general account called "Drafts Payable." It appeared that these latter entries were solely for the convenience in accounting between Knauth, Nachod and Kuhne and Banca Commerciale Italiana and that First National Bank of Denver did not know how or from what funds payment would be made, relying solely upon their agreement with Knauth, Nachod and Kuhne, and depending on them to procure payment of the check or draft. It also appeared that in previous similar cases Banca Commerciale Italiana had frequently cancelled such entries and transferred funds from "Drafts Payable" back to the general account of Knauth, Nachod and Kuhne, acting solely upon the directions of the latter.

Before the check or draft above mentioned was presented Knauth, Nachod and Kuhne were adjudged bankrupts. The Equitable Trust Company was appointed trustee of their estate. First National Bank of Denver, having, as drawer of the draft, been compelled to pay the amount to the holder, claimed that the transaction above amounted to an equitable assignment of or the creation of a trust in the funds held by Banca Commerciale Italiana to the credit of Knauth, Nachod and Kuhne. The majority of this court held that there was no equitable assignment and that no trust was created. As the division in this court indicates, it is always difficult to determine equities of a third person under a contract to which he is not a party but from which he may expect some incidental benefit. Perhaps no single test may

be applied to all cases, but knowledge of the contract on the part of the equitable claimant is generally essential. The claimant can seldom contend successfully that he has an equitable claim arising from a contract of which he was ignorant.

The opinion of the majority of the court is based upon the fact that First National Bank of Denver had contracted with Knauth, Nachod and Kuhne alone and were strangers to and ignorant of the agreement with Banca Commerciale Italiana, so that no reliance could have been placed upon the dealings between Knauth, Nachod and Kuhne and its foreign correspondent. In the case at bar every bank which deposited with the Federal Reserve Bank a check on the Lake City bank was bound by the terms of the circular and entitled to the benefit of every provision in it. The terms of the circular were the inducement for the deposit of the checks. It is negligent to send a check to the drawee without express authority or to adopt any method of settlement with the drawee except payment in lawful money unless the depositor has approved the method employed (See *Federal Reserve Bank* v. *Malloy*, 264 U. S. 160, 44 Sup. Ct. 296, 68 L. Ed. 617). The Federal Reserve Bank had, therefore, no authority to surrender these checks to the Lake City bank except upon the terms and conditions set out in the circular, and by the express terms of the circular the checks it surrendered to the drawee bank were chargeable to its reserve account if not returned. If the Federal Reserve Bank had attempted to waive this condition, it would have rendered itself liable to the depositing banks. To deny effect to this condition is to abrogate an essential provision of the contract under which the checks were deposited by the member banks and under which they were entrusted to the Lake City bank, for the depositing banks had consented to the surrender of the checks to the Lake City bank upon the terms and conditions stated in the circular and upon no other terms.

CONCLUSION

We submit in conclusion that the decision of the Circuit Court of Appeals depends entirely upon the construction of a contract between the Federal Reserve Bank of Richmond and its member banks, and so involves no important question of general law, and, furthermore, the construction placed upon the contract by the Circuit Court of Appeals is so plainly right that a review by certiorari will be inappropriate and would not serve to promote the ends of speedy justice.

Respectfully submitted,

M. G. WALLACE,

Counsel for the Respondent.

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Supreme Court of the United States

OCTOBER TERM, 1929.

No. 226.

THOMAS A. EARLY, RECEIVER OF THE FARMERS & MERCHANTS NATIONAL BANK OF LAKE CITY,
PETITIONER,

versus

FEDERAL RESERVE BANK OF RICHMOND,
RESPONDENT.

ON CERTIORARI FROM THE U. S. CIRCUIT COURT OF APPEALS FOR THE FOURTH CIRCUIT.

BRIEF OF RESPONDENT.

M. G. WALLACE,
For Respondent.

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THE WILLIAM BYRD PRESS, INC., RICHMOND, VA.

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BRIEF OF RESPONDENT.

OBJECT OF CONTRACT.

The essential facts of this case have been correctly stated by counsel for petitioner and are likewise stated in the opinion of the Circuit Court of Appeals, hence a repetition is unnecessary, but inasmuch as the case depends upon the

construction and application of a written contract made to regulate the dealings of the parties in a rather complicated series of transactions, we consider that a statement of the methods commonly used by banks in collecting checks is desirable in order to enable the court to determine the true intent of the parties in making this contract. The object of the contract was to prescribe a method for the handling of checks deposited by member banks with Federal Reserve banks, which checks were drawn upon other banks, and the terms of the contract describe the duties of the Federal Reserve bank and the rights and liabilities of the depositing banks and the rights and liabilities of the drawee or paying banks.

Checks are the instrumentalities by means of which almost all settlements and payments between persons who live in different parts of the country are effected. Every bank receives daily on deposit or for collection many checks drawn upon other banks in different places and sections of the country. Each of these checks must be presented to the bank upon which it is drawn, and if the check is good, payment must be made by the drawee bank to the collecting bank. The Negotiable Instrument Law defining the rights and duties of the parties to a check contemplates that the holder will through himself or his agent present the check at the counter of the drawee bank, and demand money, and surrender the check to the drawee only when the money is paid; but under working conditions it is impracticable for a collecting bank to send a special messenger to present each check which is deposited with it. Banks therefore usually send checks to correspondents in financial centers and these correspondents collect the checks from the drawees and credit the proceeds to the depositing bank. The balance thus created is used by the depositing bank to pay checks drawn upon itself. The following presents a practical illustration of an ordinary method of collecting a check before the inauguration of the Federal Reserve System:

A bank in Charleston received a check payable in Richmond. The Charleston Bank sent the check to some corre-

spondent in Richmond. This correspondent collected the amount from the drawee bank. The Richmond bank was then compelled to find some method of settling with the Charleston bank for the money which it had collected. To ship the money would be risky and expensive, but the Charleston bank probably had an account with some New York bank and carried a balance with this depositary, and the Richmond bank probably had a balance with the same or some other bank in New York. The Richmond bank therefore sent to the Charleston bank a draft payable in New York, which the Charleston bank in turn sent to its New York correspondent or depositary. This depositary collected the check from the New York bank on which it was drawn and credited the amount to the bank in Charleston. The result of this transaction was that money formerly on deposit to the credit of a Richmond bank was transferred to the credit of a Charleston bank. After that the Charleston bank could use this available balance in New York as a means of settling for checks which it was obliged to pay to persons in places other than Charleston.

The above illustration is a very simple one. If we attempted to trace the process of collecting a check deposited in a bank in a small village in South Carolina and payable in a small village in Virginia, several additional steps would be necessary, but the underlyng principle was always the same; that is to say, banks kept the greater portion of their available reserves on deposit with other banks in financial centers and used these reserve deposits as a means of paying checks which were presented by holders who did not live in the same city with the drawee bank; and maintained these reserve balances by depositing with their correspondents in reserve centers checks payable in different parts of the country. If every bank in the country had its reserve in the same center, or in certain designated centers, collection of checks would be greatly facilitated, for each bank could send to these central reserve depositaries checks drawn on every other bank in the country, and the checks could be collected by a simple method of clearing under which checks received

from any bank could be credited to its reserve account, and checks paid by any bank could be charged against its reserve account. Thus the reserve account of each bank could be maintained by its collections from other banks, and this reserve would always be available to pay checks drawn on the bank. Ordinarily the volume of checks deposited with the central clearing agency by any bank, and of checks on this bank presented through the central clearing agency would be approximately equal, but, if at any time the volume of checks on any bank should be unexpectedly large, it could pay these checks by remitting funds to the central reserve agency, or, if that agency had the power of lending, by borrowing from it. Apparently realizing that the maintenance of reserves, and the use of reserves, was inseparable from the collection and payment of checks, Congress in creating the Federal Reserve banks provided that each of them might be required to serve as a collecting or clearing agency for member banks, and provided that means by which collections and clearances between Federal Reserve banks could be made. Every Federal Reserve bank was required to receive on deposit any check upon any member bank, and thus as to member banks the Federal Reserve banks would operate much in the same manner as clearing houses; that is to say, each member bank could deposit with its Federal Reserve bank a check upon any other member bank and eventually receive credit for the amount of such check unless it was returned dishonored, and each member bank would be compelled to pay to the Federal Reserve bank checks drawn on it and deposited by other member banks unless such checks were returned protested.

In the Regulations promulgated and in the Circular three classes of banks are mentioned: (1) Member banks; (2) Non-member clearing banks; (3) Non-member remitting banks.

The first class comprises, of course, banks which are members of the Federal Reserve System and therefore must maintain a reserve on deposit with the Federal Reserve bank; the second class comprises non-member banks which maintain a deposit balance in the hands of the Federal Re-

serve banks and which therefore have, as far as check collection and clearing is concerned, the privileges of member banks; and the third class consists of non-member banks which have no reserve account on deposit with a Federal Reserve bank, but are willing to remit to it in a satisfactory way for checks which may be sent by the Federal Reserve bank to the non-member bank. Dealings with the last two classes of banks mentioned are in no way concerned in this suit. We merely mention them in order that the court may understand the references to the three classes in the Circular and in the Regulation.

As between member banks the exchange and collection of checks can be conducted upon principles essentially analogous to a clearing house; that is to say, every member bank can deposit every check which it receives upon any other member bank in the Federal Reserve bank and all checks received by the Federal Reserve bank upon any member can be sent to it and settlement can be made by the simple expedient of charging and crediting checks presented by one bank and accepted and cancelled by another.

In a city clearing house the operation of charging and crediting is simultaneous so that all members receive immediate credit for all checks drawn on other members placed in the clearing house and are charged with all checks drawn upon themselves presented through the clearing house, and, of course, if any check be returned unpaid, the bank returning it is credited and the bank depositing it is charged. When such operations are conducted at a daily meeting absolute assurance can usually be given that if a check be deposited in a clearing house it will either be returned to the depositor unpaid or else the money will be obtained from the drawee. When this system is extended to banks throughout a district, it is obvious that a check cannot be presented to the drawee on the same day that it is received at the clearing house; but time must be allowed for the check to be presented to the drawee, and returned if necessary, and for the drawee to restore its reserve if it were depleted by charging the check against it. The time allowance in the case of each

bank must of necessity vary in order that the more remote members may not be penalized by having checks charged against them before they have an opportunity to accept and pay the checks and charge them to the accounts of the drawers, and make transfers of funds to restore their reserve balances, if necessary.

The introduction of the time element, however, opens the operation of the district clearing house to one serious defect not inherent in the local clearing house. The drawee bank may cancel the checks drawn upon itself and may fail before it has met its clearing house debit, and therefore the drawee bank may at the time of its failure be a debtor in the clearing house, and other members who have deposited checks on it may be placed in the position where the drawer of the check is released and yet payment has not been obtained from the drawee bank.

Such cases as *Federal Reserve Bank* v. *Malloy,* 264 U. S. 160, 44 St. Ct. 296, and *Cleve* v. *Craven Chemical Company,* 18 Fed. (2nd) 711, and numerous other state and federal cases which have dealt with the liability of the parties when a check has been cancelled by the drawee but payment to the holder has not been made, show that the hardship suffered by the holder of a check in such an instance is very real, and the situation is a hotbed of litigation. If, for example, a merchant in one city accepts a check from a customer in another and forwards this check for collection through banking channels, the merchant may find that the operation necessary to collect this check in a convenient manner has resulted in the release of his customer who sent him his check, and the substitution of a claim against an insolvent bank in a remote place wholly unknown to the merchant. If this situation could be avoided, it would be a "consummation devoutly to be wished." It is not possible to devise a plan under which the situation will never occur, but a provision under which the reserve balance would always be applicable to the payment of any check cancelled and not returned reduces the danger to a minimum. Since one object of the check clearing system of the Federal Reserve

banks was to encourage the free use of checks upon member banks and to give to such checks currency in the business world by providing the best possible means for their collection there was every reason to endeavor to avoid any losses to the holders of checks deposited, if possible, for every holder who fails to obtain payment of a check which has been handled through the Federal Reserve banks naturally loses some confidence in the System.

The Federal courts have consistently held that ordinarily a collecting bank is obliged to present a check received on deposit to the drawee and demand payment in money, and is liable to its depositor if it does not obtain payment, or return the check unpaid with the liability of the drawers and endorsers preserved. The reason for the establishment of this rule appears to have been the realization of the danger which is unavoidable in any method of collection which involves a surrender of the check to the drawee before the amount is actually paid. A collecting bank may of course by special contract relieve itself of this liability, as the Federal Reserve banks have done; but in so doing it imposes the unavoidable risk on its depositor. It is apparent that, having done this, the collecting bank should seek to make such an arrangement as will reduce to a minimum the inevitable risk inherent in working conditions. The nearest possible approach to a presentation of the check to the drawee, and a surrender of the check only when payment is made, is a system under which the check is mailed to the drawee under an agreement authorizing the forwarding bank to charge it against funds of the drawee in the forwarding bank's hands unless the check is returned.

ARGUMENT ON PETITIONER'S POINT A.

In their argument under this point counsel for petitioner emphasized that the charge against the reserve balance of the Lake City bank was not to be made until the expiration of the transit time, i. e., three days. We have endeavored to show that this interval was allowed as a matter of neces-

sity because of the situation of the parties and the inability of one to learn of the actions of the other except by communicating in the ordinary course of mail. If the charge had been made earlier, in many cases the effect would be that the Lake City bank would be charged with checks which it had never accepted or paid, but which had been dishonored by it and returned protested. In addition, the Lake City bank could not foresee the amount of checks which would be presented on any day; hence if it were charged with the checks on the day upon which they were received and handled by it, its reserve would be apparently depleted and it would be penalized for a deficiency in reserve, even though it had immediately taken steps to restore its reserve by remittances or transfers sufficient to cover the amount of the checks. Under the rule laid down by this court in *McDonald* v. *Chemical National Bank*, 174 U. S. 610, title to remittances or transfers made by the Lake City bank would pass to the Federal Reserve bank on the day upon which such remittances and transcfers were made by the Lake City bank, even though the Federal Reserve bank was not advised of such remittances or transfers until later. Theoretically, therefore, it would probably be proper to charge the reserve account of the member bank with checks cancelled by it as of the date on which the checks were cancelled, and in computing reserves to credit the reserve account with shipments of currency or transfers as of the date upon which such shipments or transfers were made or directed, but it is obvious that under ordinary accounting system such a method of bookkeeping would be impracticable.

To hold that the necessary delay in adjusting the books, which was of necessity allowed in order to meet the practical conditions, constituted the extension of unsecured credit for checks which should have been immediately paid upon presentation, is to give a forced construction to a business agreement and is we submit to ignore utterly the plain provision:

"The right is reserved, however, to charge a cash

letter to the reserve account of a member bank at any time when in any particular case we deem it necessary to do so."

If this provision does not indicate a clear and positive intent to make the reserve balance of the member bank applicable to all checks not returned, we are unable to see that any meaning whatsoever can be assigned to this provision which was obviously inserted in the circular and regulation with the idea that it would create some definite right.

Counsel for petitioner appear to rest much of their argument upon the statement that the reserve balance was not a specific fund. We do not see how it can be said that a bank balance on deposit in a particular bank is not a specific fund. We do not see why a depositor may not agree that any sum which he has on deposit in any particular bank may be appropriated to obligations nominally due to that bank regardless of whether such obligations are due to the bank in its own right or as agent or trustee for others.

Counsel for petitioner lay great emphasis upon the statement that the drawee bank was allowed to draw against its balance during the transit period. Nothing in the record indicates that any such right on the part of the drawee was recognized by the Federal Reserve Bank. It is true that the account filed in evidence shows certain charges made after the dispatch of these letters and before a report upon them had been received, but it is extremely likely that such charges were made on account of letters previously dispatched or notes or other obligations of the drawee bank maturing and becoming chargeable in the regular order prior to the letters in question.

Since the Federal Reserve Bank could not during the transit period be aware of the disposition made of the checks, the Lake City bank might have succeeded in withdrawing its balance, leaving the checks unprotected, but the rights of the parties cannot be determined by the probability that one could have taken advantage of the other. That the Lake City bank, after cancelling the checks, could not have

compelled or required the payment of the balance seems too clear to require demonstration.

Assume that on the afternoon of October 9th the Cashier of the Lake City bank had called the Federal Reserve Bank and had demanded that currency to the amount of the apparent balance be shipped to the Lake City bank, would the Federal Reserve Bank have been compelled to ship this amount, or could it have replied that the balance would be held and credited as a payment on the letters of October 7th and 8th? We would be willing to rest this entire case upon the answer to this question, and it seems to us that to answer this question it is only necessary to read the plain and unambiguous words of the provision under which these checks were surrendered to the Lake City bank. If the Lake City bank could not have demanded and compelled payment of the balance on October 9th, the receiver could not do so, for it is elementary that the rights of the parties are determined by the status existing when insolvency intervenes, and the receiver can enforce only such right as the insolvent might have enforced at the moment of suspension.

In cases depending upon the construction of contracts it is always difficult to cite authorities which are exactly in point. The contracts under consideration are rarely identical, but in every case which we have examined in which a similar contract or arrangement has been considered the courts have held that the balance of the failing bank was applicable for the payment of such liabilities, even though the collecting bank acted only as agent.

The following cases will be found to be very similar to the case at bar:

Storing v. *First National Bank* (C. C. A. 8th), 28 Fed. (2nd) 587.

Federal Reserve Bank v. *First National Bank* (U. S. D. C.), 277 Fed. 300.

Midland National Bank and Trust Co. v. *First State Bank of Sioux Falls* (175 Minn. 555), 222 N. W. 274.

Farmers National Bank v. *Penn Bank*, 123 Pa. 283, 16 Atl. 761.

Penn Bank v. *Farmers National Bank*, 130 Pa. State 209, 20 Atl. 150. (Affirming case next above without opinion.)

The case of *Federal Reserve Bank* v. *First National Bank*, *supra*, and the unpublished decision in *Keyes, Receiver*, v. *Federal Reserve Bank*, which is printed as an appendix, deserve, we think, especial consideration, even though they are decisions of district courts, because these cases involve dealings of member banks with Federal Reserve banks and construe a Regulation of the Federal Reserve Board which on the particular point was substantially the same as the Regulation enforced when the case at bar arose.

In both of these cases it was held that the reserve balance of the failing member bank should be applied in payment of checks. Both cases concerned receivers of national banks acting under the control of the Comptroller of the Currency. In neither case were appeals taken, and these decisions were left to stand as the only available statement of the law for a period of several years.

We submit that the acquiescence of the Comptroller of the Currency in the decisions mentioned above amount practically to an executive construction of the act upon which the Federal Reserve Bank was entitled to rely and which should not be reversed unless clearly erroneous.

In the case at bar it appears that the Federal Reserve Bank and the holders whose checks were in the letter of October 7th had every reason to believe that they had received final and irrevocable payment for their checks, and that the Receiver appears to have at first assumed that the charge of this letter was proper (Record, page 15), and not until six months after the suspension was there any intimation that any question would be made of the propriety of charging this letter of October 7th, in accordance with the rule laid down in the only decided cases upon the subject (Record, page 21). Obviously the reversal of a long ac-

cepted interpretation will work great hardship on the holders of the checks in the letter of October 7, 1929.

ARGUMENT ON PETITIONER'S POINT B.

Counsel for petitioner under this head contend that the collection of checks by Federal Reserve banks is not dependent upon the reserve balances of member banks.

It is of course true that the two are not inseparably connected. It would have been possible to create central banks authorized to act as reserve depositories only, and it would have been possible to create central clearing agencies to act as intermediaries in the clearing and collection of checks, but we have endeavored to show that the combination of the two functions was suggested by past banking experience and the exercise of one function was a great aid to the convenient performance of the other.

Counsel for petitioner seem to consider that the primary purpose of requiring the maintenance of a reserve is to accumulate a fund to be used in lending to member banks. It is true that the consolidation of the reserves of all banks in a single reserve system permits this use, but the primary purpose of requiring the maintenance of a reserve is to enable a bank to meet demands made upon it by its depositors promptly and effectively. These demands are usually made by checks. Checks are presented in one of three ways:

(a) By the holder at the counter of the drawee bank.

(b) By other banks in the same place, usually through a local clearing house.

(c) By banks in other places, almost always through the mails.

The volume of checks presented in the first way is normally small and perhaps the majority of checks so presented are presented by other depositors of the drawee bank who merely desire credit, so that only a small amount of currency is used in these counter transactions. Checks presented in

the second way are to a large extent set off against checks on the other banks in the town held by the paying bank. The chief use of a balance in a reserve depository is to meet promptly checks presented in the third way.

Since Federal Reserve banks are required to receive at par checks on all of their member banks, the majority of checks on member banks which circulate outside of the place in which the member bank is situated are presented through Federal Reserve banks. Therefore, a system under which the balance in the hands of the Federal Reserve bank can be used to pay checks presented through the Federal Reserve bank by the simple process of charging and crediting affords a simple and expeditious way of clearing such checks and one under which the member bank can use its reserve with greatest convenience for the purpose for which it is primarily intended and the holders of the checks can obtain the benefits of a safe and expeditious method of collection.

Counsel for petitioner state that the exercise of clearing house functions by Federal Reserve banks was permissive but not mandatory. We believe that they have failed to give due consideration to all of the provisions of the Federal Reserve Act. Federal Reserve banks are by the Act required to receive checks on member banks. Section 16 of the Federal Reserve Act (38 Stat. 265, 12 U. S. C. 360), reads in part as follows:

> "Every Federal Reserve Bank shall receive on deposit at par from member banks or from other Federal Reserve Banks checks and drafts drawn upon any of its depositors."

This court recognized in its decision in *Farmers and Merchants Bank of Monroe* v. *Federal Reserve Bank*, 262 U. S. 649, 43 Sup. Ct. 651, 67 L. Ed. 825, that this language was mandatory and distinguished it from language authorizing the receipt of checks upon non-member banks.

If checks upon member banks are received by Federal Reserve banks, some method of collecting them must be ar-

ranged. Such a method might be arranged by the Federal Reserve bank by agreement with its member banks, but it would not be improbable that disagreements might arise with respect to such arrangements, and the Federal Reserve Board was therefore authorized to regulate the clearing functions of Federal Reserve banks.

By Section 19 of the Federal Reserve Act, 12 U. S. C. 464, quoted by counsel for petitioner, reserve balances of member banks are subject to withdrawal under regulations prescribed by the Federal Reserve Board. The Federal Reserve Board, exercising the powers mentioned above, issued Regulation J prescribing a plan for the clearing and collection of checks, providing among other things: "That any Federal Reserve Bank may reserve the right in its check collection circular to charge such items to the reserve or clearing account of any such bank at any time when in a particular case the Federal Reserve Bank deems it necessary to do so."

The Federal Reserve Bank of Richmond, availing itself of this provision of the Regulation, reserved the right to charge the reserve balance. The Lake City bank knew that this right had been reserved and received the checks with this knowledge. Every depositing bank knew that the right had been reserved. Hence we submit that while the method adopted may not be the only method which might lawfully be adopted, it was the method to which all parties to this transaction assented and by which they must of necessity be bound.

In the second sub-division under this point petitioner contends that the authority of the Federal Reserve Bank to withdraw funds from the account of the Lake City account was revoked by the suspension of the latter. This argument appears to be founded upon the assumption that the Federal Reserve Bank was an agent of the Lake City bank. The circular and regulation declare that the Federal Reserve Bank acts as agent for the depositing banks. Its duty was to collect these checks from the Lake City bank. Its relation to the Lake City bank was that of a collecting agent to a

debtor, which is certainly inconsistent with the position of an agent for a debtor.

The liability of the Lake City bank arose from no act done by the Federal Reserve bank but entirely from acts done by the Lake City bank in its own behalf and right and before its suspension, when it had full power to dispose of its assets in any lawful manner.

Before suspension the Lake City bank received these checks upon the condition that they should be charged against its reserve balance if not returned. The checks were cancelled and charged to the drawers by the Lake City bank. Thereby its obligation to pay these checks in the manner agreed upon became absolute and irrevocable. At the time of the suspension not one act remained to be done by the Lake City bank to complete this part of the transaction and to dedicate its reserve balance to the payment of these checks. All that remained to be done was the posting of the books of the Federal Reserve Bank and the entries on the books of the Federal Reserve Bank were delayed only because of the physical necessities of the case.

Counsel for petitioner lay some stress upon the fact that the Lake City bank could establish a balance sufficient to cover its liability for the checks in any one of several ways. This of course was true; but so far as the balance in the hands of the Federal Reserve Bank would avail, the Lake City bank had already provided available funds, and no further action in this respect was necessary or possible. The balance in the hands of the Federal Reserve Bank was at the moment of suspension available for the payment of liabilities of the Lake City bank and the latter had positively agreed that the amount of checks cancelled by it could be charged against this balance.

That the right of the parties in such a case depends upon the actions done by the failing bank and not upon the state of the books, or even the knowledge of the collecting bank, was held by this court in *McDonald* v. *Chemical National Bank*, 174 U. S. 610. In that case the Capitol National Bank of Lincoln, Nebraska, was indebted to the Chemical National

Bank of New York, which indebtedness appears to have arisen in part from checks sent to the former by the latter. Before closing its doors the Capitol National Bank made certain remittances to the Chemical and directed other correspondents to transfer funds to it. These remittances and transfers were neither received nor credited by the Chemical before the suspension of the Capitol National Bank. This court held nevertheless that the right of the Chemical National Bank to hold these funds was complete because all acts necessary to perfect this right were done by the Capitol National before suspension and the posting of the books of the Chemical was not necessary to perfect its right.

ARGUMENT ON PETITIONER'S POINT C.

This section of petitioner's brief is confined to the proposition that the decision of the Circuit Court of Appeals is inconsistent with the principles of law enunciated by this court in *Equitable Trust Company* v. *First National Bank*, 275 U. S. 359, 48 Sup. Ct. 167. The Circuit Court of Appeals discussed the above decision fully and pointed out that the facts bore no analogy to the facts of the present case. A statement of the facts in that case is the best method of distinguishing it.

Knauth, Nachod and Kuhne were bankers apparently dealing in foreign exchange and had a contract with the First National Bank of Denver whereby the latter might draw drafts on banks in foreign countries and the former would arrange for the payment of such drafts on presentation. In pursuance of the agreement First National Bank of Denver drew a check or draft on Banca Commerciale Italiana and requested Knauth, Nachod and Kuhne to protect the same. They requested Banca Commerciale Italiana to honor the draft for their account. Banca Commerciale Italiana upon receipt of the request from Knauth, Nachod and Kuhne charged the amount to their account and credited it to a general account called "Drafts Payable." It appeared that these latter entries were solely for the convenience in ac-

counting between Knauth, Nachod and Kuhne and Banca Commerciale Italiana and that First National Bank of Denver did not know how or from what funds payment would be made, relying solely upon their agreement with Knauth, Nachod and Kuhne, and depending on them to procure payment of the check or draft. It also appeared that in previous similar cases Banca Commerciale Italiana had frequently cancelled such entries and transferred funds from "Drafts Payable" back to the general account of Knauth, Nachod and Kuhne, acting solely upon the directions of the latter.

Before the check or draft above mentioned was presented Knauth, Nachod and Kuhne were adjudged bankrupts. The Equitable Trust Company was appointed trustee of their estate. First National Bank of Denver, having, as drawer of the draft, been compelled to pay the amount to the holder, claimed that the transaction above amounted to an equitable assignment of or the creation of a trust in the funds held by Banca Commerciale Italiana to the credit of Knauth, Nachod and Kuhne. The majority of this court held that there was no equitable assignment and that no trust was created. As the division in this court indicates, it is always difficult to determine equities of a third person under a contract to which he is not a party but from which he may expect some incidental benefit. Perhaps no single test may be applied to all cases, but knowledge of the contract on the part of the equitable claimant is generally essential. The claimant can seldom contend successfully that he has an equitable claim arising from a contract of which he was ignorant.

In analyzing the opinion of Mr. Justice Holmes, counsel for petitioner pointed out that the decision in the case under discussion was based upon three essential elements. It appears to us that none of these elements are present in the case at bar, but, indeed, the agreement of the parties in the case at bar is in its essential features exactly opposite in its effect to the agreement of the parties in the Trinidad case.

The first essential element mentioned by counsel for petitioner is:

(1) The ignorance of the whole affair on the part of the holder.

In the case at bar every holder of a check sent to the Lake City bank was charged with knowledge that it would be handled in accordance with the terms set forth in the circular, one of which was the right to charge the amount of the check against the reserve balance of the Lake City bank if it were not returned.

The second element mentioned by counsel for petitioner is:

(2) The general understanding that the account was subject to the bankrupt's control.

As we endeavored to point out above, the reserve account of the Lake City bank could not have been described as subject to its control at the time of its suspension without ignoring the plain terms of the circular, for it seems evident that if the Lake City bank had demanded payment of its balance just before suspension the Federal Reserve Bank might and should have refused payment upon the ground that it had the right to apply the balance in payment of the checks.

The third element discussed by the petitioner is in substance that the bankrupt in the Trinidad case had not agreed to appropriate any special funds to the payment of this check, but in the case at bar the Lake City bank had definitely and positively agreed that its reserve balance might be so appropriated. It is true that the exact amount of the reserve balance at any particular time was indeterminate, but we respectfully submit that an agreement that a specified fund or property may be applied in settlement of a debt is not an invalid agreement because the value of the particular fund is not at all times the same.

In discussing the principles laid down above, counsel for petitioner state that if the reserve balance was chargeable with the checks as soon as they were accepted by the Lake

City bank, it would have been the duty of the Federal Reserve Bank to make this charge as soon as it was advised that the checks had been accepted. It may be true that such would have been the duty of the Federal Reserve Bank, subject, of course, to charge against the reserve balance other proper charges which had accrued prior to the acceptance of the checks in the cash letters, but we believe we have shown that under the system adopted the Federal Reserve Bank did charge the reserve balance as soon as the charge could be made in the usual and ordinary course of business, and certainly the right to make a charge is none the less valid because there must of necessity be a certain delay in ascertaining that the right has become fixed.

Under this heading counsel for petitioner point out that many charges and credits were made in the reserve account after the dispatch of the letters of October 7th and 8th and that the balance remaining on the night of October 9th was for the most part created by credits made after the dispatch of these letters.

Since these credits were made after the dispatch and probably in some instances after the reecipt of the letters of October 7th and 8th, the only fair assumption is that the credits represent remittances and transfers made by the Lake City bank in fulfillment of its agreement to place in the hands of the Federal Reserve Bank funds sufficient to meet the checks in the letters. If such be the case, then the decision in *McDonald* v. *Chemical National Bank*, 174 U. S. 610, rules the case at bar, because that case dealt with the situation in which transfers and remittances were made to cover a balance due upon an open account.

Respectfully submitted,

M. G. WALLACE,

Counsel for Federal Reserve Bank of Richmond, Respondent.

APPENDIX.

IN THE UNITED STATES DISTRICT COURT, DISTRICT OF MINNESOTA, FOURTH DIVISION.

Paul C. Keyes, as Receiver of the First National Bank of Clarkfield, Minnesota, Plaintiff,

vs.

Federal Reserve Bank of Minneapolis, a Corporation, Defendant.

This cause came on to be heard at Minneapolis, on the 9th and 11th days of October, 1918, J. N. Johnson, Esq., appearing on behalf of the plaintiff, and A. Ueland, Esq., appearing on behalf of the defendant.

The stipulations and testimony having been taken, and each side having rested, by agreement between Court and Counsel, briefs were furnished to the Court and exchanged between Counsel, and thereafter, on the 21st day of October, 1918, the case was orally argued by Counsel.

And now the Court, having duly considered the same,

It is ADJUDGED, ORDERED and DECREED, That the plaintiff take nothing in this action, and that the defendant has a right to a claim against the Receiver for $462.06, which it may file in the Receivership proceedings, and that defendant have judgment for its costs and disbursements, to be taxed by the clerk.

By the Court,

PAGE MORRIS, *Judge.*

MEMORANDUM.

At all times mentioned herein the First National Bank of Clarkfield, Minnesota, was a national banking association duly incorporated under and pursuant to the banking laws of the United States, and up to the 18th of September, 1917, conducted business as a national bank at Clarkfield, Minnesota.

At all times mentioned herein the defendant was a corporation duly organized and existing under and pursuant to an act of Congress of the United States entitled "Federal Reserve Act," approved December 23rd, 1913, and conducting the business of a Federal Reserve Bank at Minneapolis, Minnesota.

The plaintiff's insolvent, First National Bank of Clarkfield, Minnesota, was on the 18th day of September, 1917, insolvent, and was on that day closed by order of the Comptroller of the Currency under and by virtue of the power and authority conferred upon him by the banking laws of the United States, and by virtue of the same power and authority the plaintiff was appointed the Receiver thereof and on the 4th day of October, 1917, duly qualified as such Receiver. Said First National Bank of Clarkfield was a member bank of the defendant under the provisions of the Federal Reserve Act. Pursuant to the provisions of the Federal Reserve Act the Federal Reserve Board, in the month of June, 1916, established a collection and clearing system by rules and regulations which have since been in force and effect, and prior to the transactions herein involved the defendant had become a part of such collection and clearing system, under such rules and regulations. The rules and regulations of the Federal Reserve Board provide, under the heading "Check Clearing and Collecting," as follows (Exhibit "C"):

Each Federal Reserve Bank shall exercise the functions of a clearing house under the following general terms and conditions:

(1) Each Federal Reserve Bank will receive at par from its member banks and from non-member banks in its district which have become clearing members checks drawn on all member and clearing member banks and on all other non-member banks which agree to remit at par through the Federal Reserve Bank of their district.

(2) Each Federal Reserve bank will receive at par from other Federal Reserve Banks and will receive at par from all member and clearing member banks, regardless of their location, for the credit of their accounts with their respective Federal Reserve Banks, checks drawn upon all member and clearing member banks of its district and upon all other non-member banks of its district whose checks can be collected at par by the Federal Reserve Bank. The Federal Reserve Banks will prepare a par list of all non-member banks to be revised from time to time, which will be furnished to member and clearing member banks.

(3) Immediate credit entry upon receipt subject to final payment will be made for all such items upon the books of the Federal Reserve Bank at full face value, but the proceeds will not be counted as part of the minimum reserve nor become available to meet checks drawn until actually collected, in accordance with the best practice now prevailing.

(4) Checks received by a Federal Reserve Bank on its member or clearing member banks will be forwarded direct to such banks and will not be charged to their accounts until sufficient time has elapsed within which to receive advice of payment.

(5) In the selection of collecting agents for handling checks on non-member banks, which have not become clearing members, member banks will be given the preference.

(6) Under this plan each Federal Reserve Bank will receive at par from its member and clearing member banks

checks on all member and clearing member banks and on all other non-member banks whose checks can be collected at par by any Federal Reserve Bank. Member and clearing member banks will be required by the Federal Reserve Board to provide funds to cover at par all checks received from or for the account of their Federal Reserve Banks. *Provided, however,* that a member or clearing member bank may ship currency or specie from its own vaults at the expense of its Federal Reserve Bank to cover any deficiency which may arise because of and only in the case of inability to provide items to offset checks received from or for the account of its Federal Reserve Bank.

(7) Section 19 of the Federal Reserve Act provides that—

The required balance carried by a member bank with a Federal Reserve Bank may, under the regulations and subject to such penalties as may be prescribed by the Federal Reserve Board, be checked against and withdrawn by such member bank for the purpose of meeting existing liabilities: *Provided, however,* that no bank shall at any time make new loans or shall pay any dividends unless and until the total balance required by law is fully restored.

It is manifest that items in process of collection can not lawfully be counted as part of the minimum reserve balance to be carried by a member bank with its Federal Reserve Bank. Therefore, should a member bank draw against such items the draft would be charged against its reserve balance if such balance were sufficient in amount to pay it; but any resulting impairment of reserve balances would be subject to all the penalties provided by the Act.

In as much as it is essential that the law in respect to the maintenance by member banks of the required minimum reserve balance shall be strictly complied with, the Federal Reserve Board, under authority vested in it by section 19 of the Act, hereby prescribes as the penalty for any deficiency in reserves a sum equivalent to an interest charge on the amount of the deficiency of 2 per cent per annum

above the ninety-day discount rate of the Federal Reserve Bank of the district in which the member bank is located. The Board reserves the right to increase this penalty whenever conditions require it.

For the purpose of keeping their reserve balances intact member banks may at all times have recourse to the rediscount facilities offered by their respective Federal Reserve Banks.

(8) Each Federal Reserve Bank will determine by analysis the amounts of uncollected funds appearing on its books to the credit of each member bank. Such analysis will show the true status of the reserve held by the Federal Reserve Bank for each member bank and will enable it to apply the penalty for impairment of reserve.

A schedule of the time required within which to collect checks will be furnished to each bank to enable it to determine the time at which any item sent to its Federal Reserve Bank will be counted as reserve and become available to meet any checks drawn.

(9) In handling items for member and clearing member banks, a Federal Reserve Bank will act as agent only. The Board will require that each member and clearing member bank authorize its Federal Reserve Bank to send checks for collection to banks on which checks are drawn, and, except for negligence, such Federal Reserve Bank will assume no liability. Any further requirements that the Board may deem necessary will be set forth by the Federal Reserve Banks in their letters of instruction to their member and clearing member banks. Each Federal Reserve Bank will also promulgate rules and regulations governing the details of its operations as a clearing house, such rules and regulations to be binding upon all member and non-member banks which are clearing through the Federal Reserve Bank.

And the rules and regulations governing the details of its operations as a clearing house promulgated by defendant provide, under the heading "Check Clearing and Collecting," as follows (Exhibit "B"):

1. The Federal Reserve Bank of Minneapolis will discontinue its present collection system on July 15, 1916, in accordance with Federal Reserve Board Circular 1, Series of 1916, already sent you, and will thereafter, until further notice, receive from its member banks for immediate credit at par, checks drawn on all member banks in the United States and on such non-member banks as can be collected at par.

A par list of all non-member banks will be prepared, to be revised from time to time, which will be furnished member banks.

All such checks, except those drawn on Minneapolis and St. Paul banks, received by the Federal Reserve Bank by 3:00 P. M., except Saturday, when the hour will be 12:00 o'clock noon, will be credited subject to final payment at full face value upon day of receipt. Those received later than these hours will be credited upon the following business day. *The proceeds, however, will not be counted as reserve, nor become available to meet checks drawn, until actually collected.* Owing to the clearing house, checks drawn on Minneapolis and St. Paul banks received after 10:30 A. M., will not be credited nor proceeds become available until the following business day; those received before that hour will be credited on day of receipt and proceeds will be available that day.

3. Checks received by the Federal Reserve Bank, drawn on its member banks, will be forwarded direct to such member banks, and *will be charged to their accounts on the date which, under usual conditions, advice of payment may be expected.* Member banks should *credit* all remittances received from the Federal Reserve Bank upon day of receipt, advising the Federal Reserve Bank, and should not remit their drafts in payment. *Member banks are required by the Federal Reserve Board to provide funds to cover at par all checks received from, or for the account of, their Federal Reserve Bank.*

Section 19 of the Federal Reserve Act provides that:

"The reserve carried by a member bank with a Federal Reserve Bank may, under the regulations, subject to such penalties as may be prescribed by the Federal Reserve Board, be checked against and withdrawn by such member bank for the purpose of meeting existing liabilities: Provided, however, *that no bank shall at any time make new loans or shall pay any dividends unless and until the total reserve required by law is fully restored.*"

7. In handling items for member banks, the Federal Reserve Bank of Minneapolis acts as agent only. It is understood that each member bank authorizes it to send checks for collection direct to banks on which checks are drawn, and except for negligence the Federal Reserve Bank of Minneapolis assumes no liability until funds are actually in its hands.

In September, 1917, there was and still is at Clarkfield, Minnesota, where the First National Bank of Clarkfield was located and doing business, a bank organized under the laws of Minnesota called the Clarkfield State Bank; and during all of said month this bank was a non-member bank of defendant upon which defendant could collect checks at par; and said bank was on the par list of non-member banks perpared by defendant and furnished to its member banks in accordance with said rules and regulations.

On the 17th of September, 1917, checks payable on presenstation amounting to $1,998.21 were deposited with defendant. These checks to the amount of $1,943.96 were on said Clarkfield State Bank and to the amount of $54.25 on said First National Bank of Clarkfield. These checks to the amount of $548.49 were so deposited by the Northwestern National Bank of Minneapolis, Minnesota, a member bank of defendant; and to the amount of $555.21 by the Merchants National Bank of St. Paul, Minnesota, a member bank of defendant; and to the amount of $218.30 by the Peoples Bank of St. Paul, Minnesota, a member bank of defendant; and

one check for $570.86 by the First National Bank of Chicago, Illinois, a national banking association, and as such a member of the Federal Reserve Bank; and one check for $5.35 by the Corn Exchange National Bank of Chicago, Illinois, a national banking association, and as such a member of the Federal Reserve Bank; and one check for $100 by the Des Moines National Bank of Des Moines, Iowa, a national banking association, and as such a member of the Federal Reserve Bank. Each check when deposited with defendant contained on the back thereof the unrestricted and unconditional endorsements in blank of the payee thereof and of the bank depositing the same with defendant and credit was on that day given by defendant at par to the bank depositing the same.

After said checks were deposited with defendant and credit given for them as aforesaid, and on said 17th day of September, 1917, defendant forwarded all said checks by mail to said First National Bank of Clarkfield, for payment and credit as to the checks for $54.25 on said bank, and for collection and credit as to the checks for $1,943.96 on the Clarkfield State Bank, and all said checks were received by said First National Bank of Clarkfield on the 18th of September, 1917.

On said 18th of September, 1917, the First National Bank of Clarkfield cleared with said Clarkfield State Bank checks which each then held against the other, and in this clearing the First National Bank of Clarkfield used all the checks on the State Bank of Clarkfield received from defendant as aforesaid and received credit for the same from said Clarkfield State Bank, but received no money. In said clearing the First National Bank of Clarkfield surrendered and delivered to the Clarkfield State Bank as fully paid and cancelled, all the checks on the latter bank which it had received from defendant, and the First National Bank of Clarkfield thereupon and on said 18th of September, 1917, and before it was closed or a receiver appointed for it, gave defendant credit on its books for all the checks which it received from defendant on that day as aforesaid, to-wit, for the sum of $1,998.21.

The checks for $54.25 on the First National Bank of Clarkfield were returned by said bank or the plaintiff to the various drawers thereof, and the checks for $1,943.96 on the Clarkfield State Bank were returned by it to the various drawers thereof, by reason whereof a more particular description of any of said checks can not be given.

No remittance or payment was ever made to defendant or any of the payee or endorsers of any of the above mentioned checks for or on account of such checks, or for or on account of the credit which defendant received on the books of said First National Bank of Clarkfield for said checks.

Thereafter, and on the 16th of October, 1917, defendant charged back severally to the various banks which had deposited the checks aforesaid, amounting to $1,998.21, the amount of said checks which had been so deposited by each of said banks. And thereafter, and on the 14th day of May, 1918, this action was brought.

On the 18th day of September, 1917, the First National Bank of Clarkfield had a balance to its credit on the books of defendant of $8,647.04. On the 25th of January, 1918, upon an accounting between plaintiff and defendant it was found that said bank was entitled to a credit for the amount of its stock in defendant with dividends accrued thereon to September 1, 1917, of $963, and to a further credit for unearned discounts on notes due March 1, 1918, of $21.90, making in all $9,631.94, and that defendant had a right to deduct therefrom the amount of certain forged notes (the forgery having been discovered after the closing of the bank for insolvency), with interest, which had been discounted by said bank with defendant prior to the 18th of September, 1917, for the purpose of replenishing the reserve of said bank with defendant and the proceeds of which forged notes constituted a part of said balance of $8,647.04. After making these credits and deductions a balance of $1,536.15 was found to be due from defendant to said bank unless defendant has the right to set off against this balance the amount of the aforesaid checks for $1,998.21.

On said 18th of September, 1917, and for some time prior thereto, said First National Bank of Clarkfield was insolvent and was known by its cashier and one of its directors to be insolvent.

The sole contention and question to be decided here is as to whether or not the defendant is entitled to offset against the aforesaid balance of $1,536.15, the amount of the aforesaid checks, $1,998.21, the plaintiff contending that it has not the right to do so and the defendant that it has.

Under the pleadings and proofs here whether the offset be legal or equitable in its nature the right to its allowance can be determined in this action U. S. Comp. Statutes, Sec. 1251-b (Judicial Code 247-b, as amended by Act of March, 1915, Ch. 90, 38 U. S. Statutes at large, 956).

That defendant handled said checks as a clearing house, for the purpose of collection and clearing, and for no other purpose, is mutually conceded by counsel. Considering the matter then as a clearing house transaction it seems to me clear that, if the First National Bank of Clarkfield and the Clarkfield State Bank had been banks doing business in Minneapolis and the clearing had been had there on the 18th of September, 1917, upon finding that the $1,998.21 was due from the First National Bank of Clarkfield to defendant, the defendant would have had the right to immediate payment thereof to it by that bank either in money or by check on its balance with defendant, or to charge said amount to said bank's account and have said bank give it credit thereof, and that being done the transaction would have been completely closed. But the defendant was the clearing house for banks in a wide territory, embracing the whole State of Minnesota, and was the clearing house for these two Clarkfield banks, and these checks had to be forwarded by mail and the clearance had at Clarkfield. Is it not apparent that upon the clearance being had between the Clarkfield banks defendant had the right to a credit with the First National Bank of Clarkfield for this amount and to charge the same to the account of said bank? That credit was given, but the charge was not made. It seems to me

that defendant then had a right of action against that bank for said amount in its own name and in its own right. And if this is true, it is clear it has had that right ever since, and therefore has the right of set off. The Receiver, the plaintiff here, took the assets of the bank as a mere trustee for creditors, and not for value and without notice, and, in the absence of statute to the contrary, subject to all claims and defences that might have been interposed as against the insolvent bank. The subsequent charging back of the checks by defendant or the subsequent statements of counsel for the defendant in his letters would not in any way affect the conclusion. The recovery of the set off here will fully protect the plaintiff and he has no interest in, and is not concerned to inquire into, what was done between defendant and the banks depositing these checks or what advice has been given to defendant by its counsel. *Elmquist* v. *Markot,* 45 Minn. 305; *Vanstrum* v. *Liljengren,* 37 Minn. 191.

But let us consider the matter not as a clearing house transaction but as one of an agency for collection. The whole argument of plaintiff's counsel rests upon the proposition that as at the time the suit was brought the defendant was not the owner of the checks, they having, on the 16th of October, 1917, been charged back to the banks which had deposited them with defendant for collection, defendant has now no right of set off. He also quotes from letters written by defendant's counsel subsequent to the closing of the bank which he contends supports his proposition, and he claims that these letters and the charging back of the checks work an estoppel against the defendant's now asserting the right of set off. It does not seem to me that these statements of counsel and the charging back of the checks in any way effect the rights of the parties here. As to the claim of estoppel it may be said that the most essential element of an estoppel is absent. In the charging back of the checks and the statements of counsel for defendant there has been no act, representation or concealment upon which plaintiff or his insolvent has been induced to act, nor has there been any action by plaintiff or his insolvent in reliance

thereon of a character to result in substantial prejudice to him or to his insolvent or to the creditors for whom as receiver he is trustee of the assets of the insolvent. It seems to me that the rights of the parties became fixed as of the time of the closing of the bank. *Scott* v. *Armstrong*, 146 U. S. 499-511. At that time defendant had a right of action against plaintiff's insolvent for the amount of the checks, whether or not they were only received by it as an agent for collection and conditional credit, and whether or not the endorsements thereon were restricted or uninrestricted. General Statutes of Minnesota 1913, Section 5848 and 5849. The subsequent ownership of the checks is unimportant. There was no defense as to the checks and no defense as to the credit arising therefrom on the books of the insolvent bank. The plaintiff has no standing to inquire into the relations between defendant and its depositing banks. Neither the insolvent nor its receiver has any concern with the question of the ownership of the checks, unless a defense be shown as against the endorsers or drawers thereof, or that defendant became the holder thereof after the closing of the bank for insolvency, or after knowledge of its insolvency. There is no such showing, and on the contrary the opposite appears. *Farmers Deposit National Bank* v. *Penn. Bank*, 123 Pa. 283; *Penn. Bank* v. *Farmers Deposit National Bank*, 130 Pa. 209.

Plaintiff's counsel contends that the allowance of the offset would work a preference contrary to the provisions of sections 5234, 5236 and 5242, Revised Statutes of the U. S. 1878 (the National Banking Act). This contention is, I think, fully disposed of adversely thereto by the decision of the Supreme Court in the case of *Scott* v. *Armstrong, supra.*

I am therefore of the opinion that defendant is legally entitled to the set off in question. And if I am in error as to that, I still think that under all the facts and circumstances of this case it is equitably entitled thereto. *Scott* v. *Armstrong, supra.* It must be remembered that the insolvent bank and its creditors received the full benefit of the amount of the checks. If the doctrine of estoppel can be

invoked at all here, it would be to prevent the receiver from objecting to the set off, at least to the amount of $1,943.96, the amount of the checks drawn on the State Bank of Clarkfield. Plaintiff's insolvent was, on the 18th of September, 1917, and for some time prior thereto, insolvent, and known to be so by its chief managing officer. Notwithstanding that fact it held itself out to be solvent, and received and handled these checks as above set forth. Relying on its solvency and induced by its holding itself out to be so, defendant forwarded these checks to it when it might have forwarded them direct to the State Bank of Clarkfield, which of course was to be substantial prejudice of defendant.

The result is, that the balance of $1,536.15 is wiped out, and defendant has the right to a claim against the receiver for the difference between that amount and $1,998.21, the amount of the checks, to-wit, $462.06.

PAGE MORRIS, *Judge.*

(ENDORSED)

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SUPREME COURT OF THE UNITED STATES.

OCTOBER TERM, 1929.

No. 226

THOMAS A. EARLY, RECEIVER FOR THE FARMERS & MERCHANTS NATIONAL BANK OF LAKE CITY, PETITIONER,

vs.

FEDERAL RESERVE BANK OF RICHMOND, RESPONDENT.

BRIEF OF J. W. POLE, COMPTROLLER OF THE CURRENCY OF THE UNITED STATES, AS AMICUS CURIÆ, IN SUPPORT OF PETITION FOR WRIT OF CERTIORARI.

F. G. AWALT,
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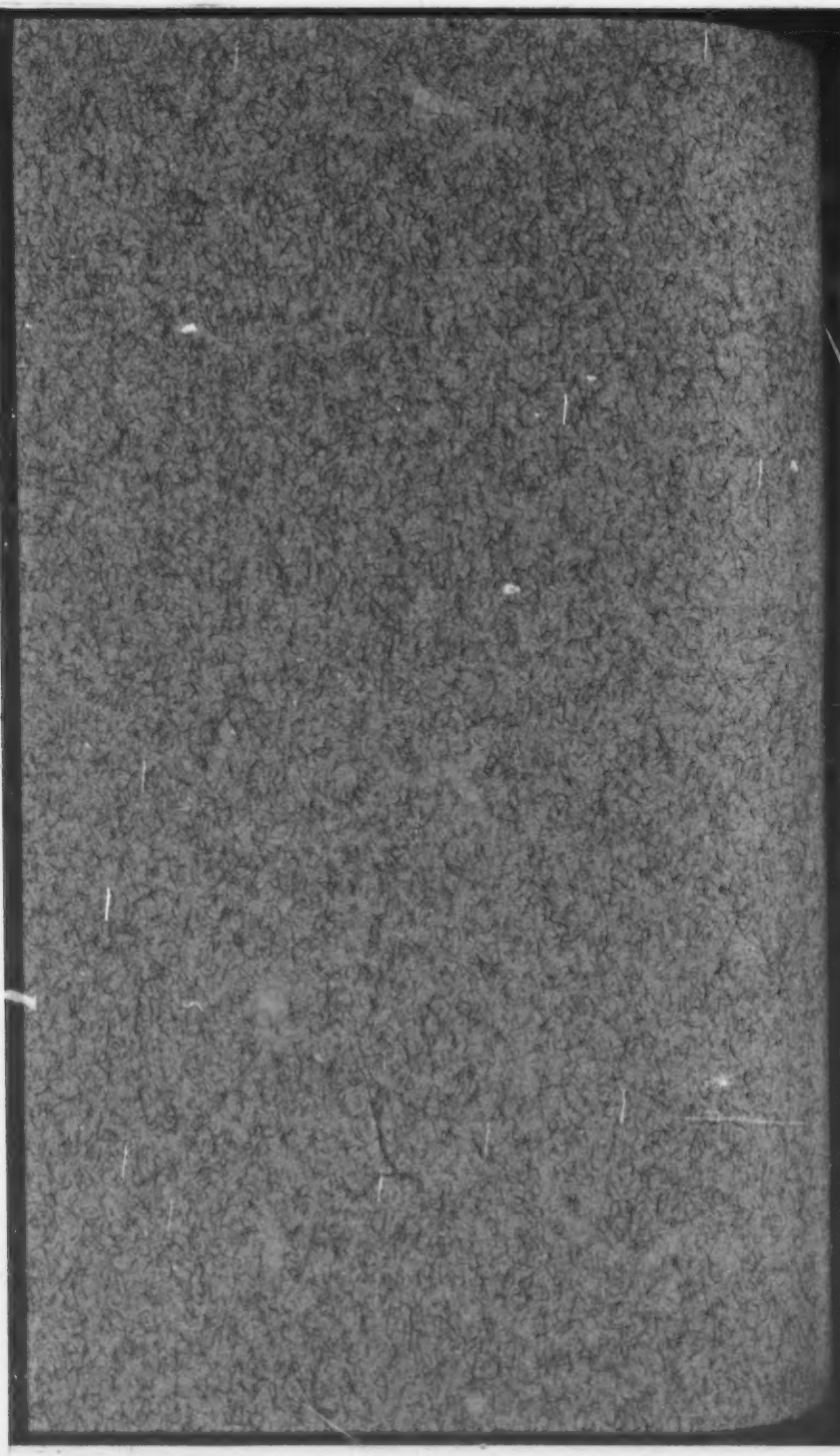
Attorneys for J. W. Pole, Comptroller of the Currency.



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SUPREME COURT OF THE UNITED STATES.

OCTOBER TERM, 1929.

No. 226

THOMAS A. EARLY, Receiver for the Farmers & Merchants National Bank of Lake City, Petitioner,

vs.

FEDERAL RESERVE BANK OF RICHMOND, Respondent.

BRIEF OF J. W. POLE, COMPTROLLER OF THE CURRENCY OF THE UNITED STATES, AS AMICUS CURIÆ, IN SUPPORT OF PETITION FOR WRIT OF CERTIORARI.

Comes now, J. W. Pole, Comptroller of the Currency of the United States, and, by leave of Court first had and obtained, respectfully submits his brief as amicus curiæ, in support of the petition for writ of certiorari heretofore filed in the above entitled cause.

Foreword.

The Comptroller of the Currency is charged by law with the supervision of receivers of insolvent national banks, and with the collection and disbursement of monies incident to the administration of the estates of such banks. (Sections 5234-36, U. S. R. S.) In his petition for writ of certiorari, and supporting brief, the Receiver of the Farmers and Merchants National Bank of Lake City has given references to the opinions below, discussed the jurisdictional requirements, clearly and adequately stated the facts in the controversy and cited authorities in support of the petition, and consequently, to avoid repetition, the matters therein covered will not be repeated in this brief. The object here is primarily to emphasize certain phases of the matter concerning the importance of the decision from the standpoint of the administration of national banks, and the reasons why it is felt that this Court would be justified in reviewing the decision of the Circuit Court of Appeals.

Finality of Judgment.

The judgment of the Circuit Court of Appeals is not final in form but it is believed that it is unquestionably final in substance.

(a) All of the facts were stipulated, and only questions of law are involved.

(b) The District Court, upon the stipulated facts, found for the Receiver concerning the reserve deposit,

and the Circuit Court of Appeals, upon the stipulated facts, reversed that judgment, its language in its opinion in that connection being:

> "With respect to the deposit balance, therefore, our conclusion is that this is not recoverable by the Receiver but should be applied by the Reserve Bank upon the checks forwarded for collection * * *. (R., pg. 76.)
>
> "Our conclusion, therefore, is that the District Judge *erred as a matter of law* in finding for plaintiff with respect to the first cause of action, which relates to the deposit account, but that his finding with respect to the second cause of action, which relates to the stock liability, is correct. The judgment rendered will be set aside, therefore, and a new trial will be awarded on the first cause of action." (Italics inserted.) (R., pg. 77.)

(c) Counsel for Respondent Reserve Bank very courteously and fairly concedes, on page 2 of his brief in opposition, that only questions of law are involved; that the decision of the Circuit Court of Appeals disposes of all such questions completely; that such decision is in substance a determination of the controversy, even though not in form a final judgment, and that although he opposes the granting of the petition for writ of certiorari on other grounds, he concedes that the petition was filed at a proper time and joins with the petitioner

> "in respectfully requesting the Court to consider the questions presented as if the decision

of the Circuit Court of Appeals had been in substance as well as form a final judgment."

(d) It may be noted that Section 240 (a) of the Judicial Code, as amended by the Act of February 13, 1925 (C. 229; 43 Stat. 936, 938), does not require that the judgment sought to be reviewed be final, and this Court has held that the application for certiorari may be granted notwithstanding the fact that the case has been remanded by the Circuit Court of Appeals for a new trial. United States *vs.* Gulf Refining Company, 268 U. S. 542; Spiller *vs.* Railroad, 253 U. S. 117; Forsyth *vs.* Hammond, 166 U. S. 506; American Construction Company *vs.* Railroad, 148 U. S. 372.

Under the circumstances it is felt that the finality of the judgment in substance, coupled with the importance of the issues involved, justify this Court in treating the judgment as a final judgment so far as concerns the consideration of same in granting or denying the petition for writ of certiorari.

Special and Important Reasons (other than the Alleged Errors of Law) Believed to Justify the Granting of the Petition for Writ of Certiorari.

It is felt that the Circuit Court of Appeals has decided an important question of Federal law, dealing with the administration of insolvent national banks, which has not been, but which should be, settled by this Court, and that the decision of the Circuit Court of Appeals is in conflict with the fundamental principles governing the administration of insolvent estates established by the decisions of this Court.

Section 5234 U. S. R. S. requires the Receiver, under the direction of the Comptroller, to collect and liquidate all assets of the bank, and Section 5236 U. S. R. S. provides that:

> "From time to time, after full provision has been first made for refunding to the United States any deficiency in redeeming the notes of such association, *the Comptroller shall make a ratable dividend* of the money so paid over to him by such receiver on all such claims as may have been proved to his satisfaction or adjudicated in a court of competent jurisdiction, and, as the proceeds of the assets of such association are paid over to him, shall make further dividends on all claims previously proved or adjudicated * * *."

The insolvent bank had on deposit with the Federal Reserve Bank of Richmond at suspension the sum of $22,088.48, and payment of same having been refused, the Receiver sued the Reserve Bank to recover the deposit, and the liquidation value of certain stock, as assets of the insolvent bank, so as to enable a pro rata distribution of the same to be made among the creditors as contemplated and directed by Sections 5234 and 5236 U. S. R. S. The Circuit Court of Appeals ruled that the value of the stock could be recovered, and the same is not here in question, but it also ruled that the Reserve Bank *must* retain such reserve balance and apply the same to the payment of the claims which certain of its depositors and customers had against the insolvent bank, said claims being based upon

checks drawn upon the insolvent bank which had been forwarded to the Reserve Bank for collection, the Reserve Bank in turn forwarding the checks to the insolvent bank for collection by letters of transmittal known as "cash letters." The result of the ruling of the Circuit Court of Appeals was that said depositors and customers of the Reserve Bank were, *by said ruling,* given a preferred status over the general creditors. The basis of the decision giving such preference was that said depositors and customers of the Reserve Bank had forwarded to the Reserve Bank for collection certain checks drawn upon the insolvent bank, and that, *by the terms of collection* agreed to and relied upon by all parties, said creditors acquired a *lien* upon said reserve balance. The application for writ of certiorari was filed to obtain a review of the ruling allowing said lien.

The terms of collection so construed are contained in the Reserve Bank's Circular No. 143 (R., pgs. 47 to 57) and the Reserve Bank's time schedule showing when the items in the cash letters become available for reserve and checking purposes (R., pgs. 57 to 59), and said Circular and time schedule are in turn based upon the terms of collection *prescribed by* Regulation J of the Federal Reserve Board, Series of 1924, (R., pgs. 43 to 47), which regulation is authorized by Section 16 of the Federal Reserve Act (12 U. S. C. A. 248 (m)). Said Regulation J applies to all Federal Reserve Banks, the provision of the regulation in that respect being:

> "Each Federal Reserve Bank shall exercise the functions of a clearing house and collect checks under the general terms and conditions hereinafter set forth." (R., pg. 44.)

Said Regulation J prescribes the terms and conditions under which said collections will be handled by the Reserve Banks, and specifically provides, in Section V thereof (R., pg. 45) that the banks sending items to the Reserve Banks for collection and clearance shall be bound by the terms and provisions of said regulation.

The regulation is therefore general in application, and the decision of the questions here involved will affect all Federal Reserve Banks and member banks handling items for collection. It will also have application to all insolvent national banks having reserve balances in Federal Reserve Banks at the time of failure and suspension and owing, at suspension, unremitted and unpaid cash letters. Consequently the decision has direct bearing upon the administration of the estates of such insolvent national banks by the Comptroller of the Currency under the Federal statutes governing such administration. In practically every case of failure of a national bank there are outstanding cash letters unremitted and unpaid, and if the decision of the Circuit Court of Appeals stands, the creditors of said insolvent banks owning the items contained in said cash letters will acquire, in consequence, a preferred status, at the expense of

the general creditors, and contrary to what is believed to be the true intent of Congress.

There is nothing contained in the Reserve Bank's Circular No. 143 and accompanying time schedule concerning the terms of collection and remittance which departs in substance from the terms and conditions prescribed by said Regulation J, and as a matter of fact Regulation J requires the promulgation by each Reserve Bank of such circulars and that the same shall not be inconsistent with the regulation, the language of the regulation in that respect, as contained in Section VI thereof, being as follows:

> "Each Federal Reserve Bank shall also promulgate rules and regulations *not inconsistent* with the terms of the law or of this regulation, governing the *details* of its check clearing and collection operations." (Italics inserted.) (R., pg. 47.)

Not only does said Circular No. 143 not depart from the requirements of Regulation J, but on the contrary it either adopts in substance or quotes verbatim the various provisions of Regulation J as its "terms of collection." By way of comparison in this respect see:

> Circular No. 143, "Conditions under which items will be received" (R., pgs. 49 to 51), and the adoption verbatim (R., pgs. 50 to 51) of the "Terms of Collection" contained in Section V of Regulation J. (R., pgs. 45 to 47.)
>
> Circular No. 143, "Availability of Proceeds" (R., pg. 52), adopting the substance of the pro-

visions concerning availability of proceeds contained in numbered paragraphs 2 and 3 of Section 4 Regulation J. (R., pg. 45.)

Circular No. 143, "Our Cash Letters to Member Banks" (R., pg. 55), relating to method of remittance and payment by collecting drawee bank, and corresponding provision in numbered paragraph 4 of Section V of Regulation J (R., pg. 46), said numbered paragraph IV of the regulation also being incorporated verbatim in Circular No. 143 under its "Terms of Collection." (R., pg. 51.)

It is therefore believed that there is no peculiar feature in the terms of collection in the instant case which can differentiate it in principle from collection cases arising under said Regulation J in all other Federal Reserve Banks, and it is believed, as before indicated, that the issues here involved are of sufficient general importance to merit consideration by this Court at this time. The question has never been passed upon by this Court, and never heretofore by a Circuit Court of Appeals, and, as hereinafter indicated, the Comptroller does not feel that the Circuit Court of Appeals has properly construed and interpreted said Regulation J and the circular of the Reserve Bank based thereon. The decision of this Court upon the merits of the question will render certain what is now an uncertain and troublesome phase of liquidation of the estates of insolvent national banks.

By way of illustration of the existing situation, it may be stated that during the pendency of this litiga-

tion the reserve balances of a number of insolvent national banks have been either wholly or partially withheld by Reserve Banks as a matter of protection to the Reserve Banks and in anticipation of possible suits against them by their depositors and customers, on the theory that the reserve balances of said insolvent national banks are subject to application for payment of cash letters outstanding at the time of suspension of said banks and unremitted and unpaid.

Merits of the Legal Questions Involved.

In view of the fact that the Receiver has filed a brief, containing full citations of authorities in support of his petition for writ of certiorari, no citations of cases will here be made, and there will be only a brief discussion of the merits from the standpoint of the basic and fundamental principles involved.

The question for determination is the right of the Reserve Bank to apply the reserve balance of the insolvent bank to the payment of the outstanding cash letters for which the insolvent bank had not made payment.

The Circuit Court of Appeals recognized that the reserve deposit could not be applied by way of offset, for the reason that the Reserve Bank was merely an agent for collection and there could be no offset of the claim of the Reserve Bank as such agent upon the claim against it by the insolvent bank for the reserve balance, due to such debits and credits not arising between the Reserve Bank and the insolvent

bank in the same capacity and there being, consequently, a lack of the mutuality necessary for offset. (R., pgs. 76-77.)

The Circuit Court of Appeals did hold, however, that the Reserve Bank could apply the reserve balance of the insolvent bank toward payment of the amounts of the unpaid cash letters, on the theory that under the terms of the contract between the parties (consisting of said Regulation J, said Circular No. 143, and said time schedule) the insolvent bank had agreed that the collection items contained in said cash letters should be charged against its reserve account at the expiration of three days, unless the items should before that time be returned, and that, by virtue of said agreement to such effect, the depositors and customers of the Reserve Bank owning said collection items acquired an equitable lien against said reserve account, and that the right to said equitable lien became fixed as soon as the insolvent drawee bank accepted and cancelled said checks and charged them to the accounts of the drawers. (R., pgs. 71-76.)

The specific question, therefore, is:

DID THE CUSTOMERS AND DEPOSITORS OF THE RESERVE BANK, WHO WERE OWNERS OF THE COLLECTION ITEMS CONTAINED IN THE UNPAID CASH LETTERS, ACQUIRE, BY VIRTUE OF THE COLLECTION CONTRACT, A LIEN AGAINST THE RESERVE BALANCE OF THE INSOLVENT NATIONAL BANK?

The provision primarily relied upon in support of the lien is contained in said Circular No. 143 under

the caption "Our Cash Letters to Member Banks" and is as follows:

> "Checks received by us drawn on our member banks will be forwarded in cash letters direct to such banks and each member bank will be required either to remit therefor in immediately available funds or to provide funds available to us to meet such cash letters within the agreed transit time to and from the member bank. Therefore, the amount of any cash letter to a member bank is chargeable against available funds in the reserve account of such member at the expiration of such transit time, which date will be shown on each cash letter. The right is reserved, however, to charge a cash letter to the reserve account of a member bank at any time when in any particular case we deem it necessary to do so." (R., pg. 55.)

The Comptroller of the Currency does not feel that the contract of collection between the parties gave the customers and depositors of the Reserve Bank who were the owners of the collection items a lien upon the reserve deposit of the insolvent bank and believes that the Circuit Court of Appeals was in error in so deciding.

(1) *Option of drawee bank either to remit for cash letters or to permit same to be charged against reserve account.*

It will be noted from the portion of Circular No. 143 above quoted that the drawee bank was

> "required *either to remit* therefor in immediately available funds *or to provide funds* available to us to meet such cash letters *within the agreed transit time* to and from the member bank. * * *"

It would seem clear from the foregoing that there was *no obligation upon the insolvent bank to pay the outstanding cash letters from its reserve account nor to preserve the reserve account intact for such purpose*, the option being *either* to remit *or* to provide available funds *within* the transit time. The drawee bank could make payment, for instance, by drawing drafts upon another bank, or by transferring funds from another bank to the Reserve Bank, or by the shipment of currency to the Reserve Bank, or by permitting the cash letters to be charged against its reserve account at the expiration of the three-day period, and hence any one of these methods of payment were available to the drawee bank as a matter of right.

There is nothing in the Reserve Act which requires the reserve account to be kept intact for the purpose of meeting cash letters, but, on the contrary, Section 19 of the Federal Reserve Act (12 U. S. C. A. 464) expressly provides that the reserve account may be checked against or withdrawn, the language of the Act in that respect being as follows:

> "The required balance carried by a member bank with a Federal Reserve bank may, under the regulations and subject to such penalties as may be prescribed by the Federal Reserve

> Board, be checked against and withdrawn by such member bank for the purpose of meeting existing liabilities. * * *"

It is to be noted in this connection that the customers and depositors of the Reserve Bank sending the items to the Reserve Bank for collection are charged with notice of, and are bound by, the provisions of Circular No. 143, Regulation J, and, of course, statutory provisions, Circular No. 143 providing in that respect:

> "Conditions Under Which Items Will be Received.—Every bank sending checks or other cash items to the Federal Reserve Bank of Richmond, or to another Federal Reserve bank direct for our account, by such act will be understood to have agreed to the terms and conditions of this circular *and of Regulation J of the Federal Reserve Board.*"

Hence said customers and depositors are charged with notice of the fact that the drawee bank does have the option of making payment in the various ways specified, and does have the right entirely to deplete the reserve account.

It would therefore seem to follow that if the drawee bank was *not* obligated to pay the cash letters from the reserve account, nor required to preserve it intact to meet such cash letters, the reserve account can not be considered as security for the payment of said cash letters and hence no lien for that purpose existed against said reserve deposit.

A lien necessarily implies mutuality of the right on the one, and of the corresponding obligation on the other—the right of the creditor to the lien or security, and the obligation of the debtor to preserve the property intact to satisfy the lien—and if, instead of this, the debtor has the legal right entirely to dissipate or deplete the fund, it does not seem logical or consistent to hold that a lien on the fund exists in favor of the creditors whose items are contained in the cash letters. Certainly it would *not* seem to follow, as suggested by the court below, that a lien arises as soon as

> "the drawee bank either unequivocably accepts the checks, as in this case, or by failing to return them promptly becomes chargeable with them under the terms of the agreement." (R., pg. 71.)

(2) *The authority given the Reserve Bank by the drawee bank to charge the reserve account was not an assignment of the reserve account funds, and such authority was revoked by notice of suspension.*

Circular No. 143 *did* give the Reserve Bank authority to charge the account of the drawee bank, in the following language:

> "Therefore, the amount of any cash letter to a member bank is chargeable against available funds in the reserve account of such member at the expiration of such transit time, which date will be shown on each cash letter. The right is reserved, however, to charge a cash

> letter to the reserve account of a member bank at any time when in any particular case we deem it necessary to do so." (R., pg. 55.)

In discussing the effect of this provision the court below took the position not only that said provision created an equitable lien, but that such lien amounted to an equitable assignment of so much of the funds as were necessary to pay the cash letters, its language in that respect being as follows:

> "And this right, we think, depends not upon the theory that the Reserve Bank is the owner of the checks or that it has the right of set off against the insolvent bank; but upon the fact that the contract of the parties has created an equitable charge upon the reserve account of the drawee bank and that such agreement operates as an equitable assignment of so much thereof as may be necessary to pay the checks when they are unequivocally accepted by the drawee. * * *" (R., pg. 72.)

There is, of course, a distinction between a lien upon a fund and an assignment of that fund, a lien being merely security for a primary debt and an assignment being a transfer of the ownership of the fund. Both, however, require integrity of the segregated or identified property, and if the lien be denied on the ground that the drawee bank was not obligated to pay the cash letters from the reserve account nor to preserve it intact for such payment, it would seem to follow, upon the same reasoning, that no assignment of the

reserve deposit was made. There can be no valid and effective assignment if the assignor has a legal right to dissipate and dispose of the property. The court below recognized this right of the drawee bank to dissipate the fund, but held, nevertheless, that the lien or assignment exists, and that only its value is affected by withdrawals from the fund, the opinion in that connection being as follows:

> "The depletion of the account may affect the value of the right of the owners of the checks; we do not see how it can affect the existence of the right. It is analogous to the right of the holder of a check in those jurisdictions where the giving of a check is held to be an equitable assignment pro tanto of the funds on which it is drawn. In such case the withdrawal of the funds before the presentation of the check may defeat the right of the holder, but this does not impair the holder's right in the fund if it is not in fact withdrawn before the insolvency of the drawer. * * *" (R., pg. 73.)

It will be noted, however, that there is a distinction between an equitable assignment and the contract provisions in the instant case. In an equitable assignment the assignor has no legal right to dispose of the property, but in the instant case the drawee bank did have the right to dispose of the property and had the right to make payment in some other manner.

It results that the right of the Reserve Bank, on behalf of its customers, to charge the reserve account was merely an unsecured authority to dispose of the

drawee bank's funds, such authority being alternative in application and executory in point of time, in that such authority could be exercised, in *normal course*, only in the event the drawee bank had not paid by some other method, and *still had available funds*, and then only at the expiration of the three-day period (subject, of course, to the right of immediate charge hereinafter discussed).

It is clear, of course, that if the drawee bank dissipates all of its reserve account, and also fails to make payment in some other manner within the three-day period, it violates its obligations to its creditors, but its conduct in that respect is no different from that of any other debtor who fails to pay his debts.

The situation, so far as the authority to charge the account is concerned, is analogous to one where the debtor has given a post-dated check which is to be used, or charged to his account, only in the event he has not paid the creditor in some other manner in the meantime. There is the obligation, in such case, to have funds on hand to meet the check at the due date, or else to have otherwise paid the debt in the interim. The post-dated check constitutes no more than an authority to the bank to charge the debtor's account on the due date. Can there be any question, in the light of well-settled principles, that, upon the insolvency or bankruptcy of the debtor before the due date of such check, the authority of the debtor to the bank is *immediately* revoked by such insolvency or bankruptcy?

Such is believed to be the situation here. The authority given the Reserve Bank was not to be exercised, in normal course, until the expiration of the three-day period. Before the expiration of such period, and therefore before the authority had been exercised, the debtor bank suspended on account of insolvency. By such suspension the authority theretofore given the Reserve Bank to charge the reserve account was revoked by operation of law, and all of the assets of the debtor bank, wherever located, including its deposit in the Reserve Bank, became the property of the Receiver for pro rata distribution among its creditors, and the depositors and customers of the Reserve Bank to whom the insolvent bank owed the items in the cash collection letters became entitled to file their claims with the Receiver for the amounts of their respective items.

There remains for discussion only the effect of the following provision of Circular No. 143:

> "The right is reserved, however, to charge a cash letter to the reserve account of a member bank at any time when in any particular case we deem it necessary to do so." (R., pg. 55.)

This provision, like the provision already discussed permitting the Reserve Bank to charge at the expiration of the three-day period, constitutes no more than an authority to charge the reserve acount. Such authority was not exercised in the instant case, prior to suspension, and hence suspension revoked the authority.

Conclusion.

It is respectfully submitted that the decision of t
lower court was erroneous and the petition for w
of certiorari should be granted.

Respectfully submitted,

F. G. AWALT,
GEORGE P. BARSE,
Attorneys for J. W. Pole
Comptroller of the Currency

(9730)

SUPREME COURT OF THE UNITED STATES.

No. 226.—October Term, 1929.

Thomas A. Early, Receiver of the Farmers & Merchants National Bank of Lake City, Petitioner, *vs.* Federal Reserve Bank of Richmond.

On Writ of Certiorari to the United States Circuit Court of Appeals for the Fourth Circuit.

[March 12, 1930.]

Mr. Justice Holmes delivered the opinion of the Court.

This is a suit brought by the receiver of a national bank in South Carolina, a member of the Federal Reserve System, to recover the reserve balance of that bank in the hands of the Federal Reserve Bank of Richmond at the end of business on October 9, 1926, when the South Carolina Bank, being insolvent, closed its doors. Other matters tried below are not in question here. The Richmond Bank claims the right to retain the balance on the following facts. As authorized by agreement, on October 7 it forwarded to the South Carolina Bank checks drawn upon the latter which the Richmond Bank had received for collection. These checks were received the next day, marked paid and charged to the accounts of the drawers. Other checks were forwarded on October 8 and marked paid and charged to the drawers by the South Carolina Bank on October 9. After notice of the failure the Richmond Bank on October 11 charged the account of the South Carolina Bank with the amount of the checks forwarded on October 7 and the next day charged what was left with the amount sent on October 8.

The relations between the two Banks were fixed by the following terms of a circular of the Richmond Bank which was authorized by law and agreed to by the other. "Checks received by us drawn on our member banks will be forwarded in cash letters direct to such banks and each member bank will be required either to remit therefor in immediately available funds or to provide funds available to us to meet such cash letters within the agreed transit time

to and from the member bank. Therefore, the amount of any cash letter to a member bank is chargeable against available funds in the reserve account of such member at the expiration of such transit time, which date will be shown on each cash letter. The right is reserved, however, to charge a cash letter to the reserve account of a member bank at any time when in any particular case we deem it necessary to do so." The transit time or time allowed for collection in this case was three days, and had not expired when the South Carolina Bank closed its doors. The Circuit Court of Appeals sustained the claim of the Richmond Bank. 30 F. (2d) 198. A writ of certiorari was granted by this Court.

The petitioner contends that his bank had until the end of the transit time to remit or to provide funds to meet the cash letters, that until then the Richmond Bank had a bare power of attorney to charge the reserve fund, and that the power was revoked by the insolvency of the petitioner's bank. He denies that the reserve fund was subject to any lien until that date, and calls attention to the right of his bank to draw checks against that fund reserved to it by the law. Code, Tit. 12, § 464.

All parties must be taken to have dealt upon the terms of the circular that we have quoted. The right of the South Carolina Bank to draw against its reserve account was subject to the right of the Richmond Bank that held the account to charge it with a cash letter whenever deemed necessary. This power is reserved more obviously in the interest of the depositors of the checks than of the Richmond Bank. The latter received the checks for collection with responsibility only for its own negligence. The depositor took the chance of finding that his only debtor was a distant bank in place of the maker of the check discharged (*Federal Reserve Bank of Richmond* v. *Malloy*, 264 U. S. 160, 166,)—a bank that might be insolvent, as this one was. His situation was the one that most needed the power to charge the reserve. The language of the circular pointed to the depositor's interest—for the cash letter that was to be charged was merely another name for the checks that the letter contained. The existence of the power must be assumed to have been one of the considerations inducing the owner of the check to give the Richmond Bank authority to send it directly to the drawee. All parties must be taken to have understood that in the event that happened it was the duty of the Richmond Bank when

it knew the facts to charge the reserve account of the South Carolina Bank, and if so the account should be charged. There was no overt act necessary in addition to what the parties had agreed upon. The case of *Equitable Trust Co.* v. *First National Bank of Trinidad*, 275 U. S. 359, cited by the petitioner, has no application because there in the opinion of the Court there was no attempt to create a lien upon an identified fund, whereas here the reserve was identified. The fact that the fund might be diminished by drafts of the South Carolina Bank does not invalidate the lien, any more than the right of a depositor to draw against his account invalidates a banker's lien, not to speak of the paramount power of the Richmond Bank mentioned above.

Judgment affirmed.

A true copy.

Test:

Clerk, Supreme Court, U. S.